S. HRG. 100-496

STEEL RETIREMENT BENEFITS FUNDING ACT OF 1987

HEARING

BEFORE THE

SUBCOMMITTEE ON LABOR

OF THE

COMMITTEE ON LABOR AND HUMAN RESOURCES UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

S. 1811

TO PROVIDE A TRANSITIONAL FUNDING METHOD TO ENSURE CONTINUED PENSION PAYMENTS TO STEEL INDUSTRY RETIREES AND TO ASSURE THE VIABILITY OF THE PRIVATE PENSION SYSTEM, AND FOR OTHER PURPOSES

NOVEMBER 20, 1987

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STEEL RETIREMENT BENEFITS FUNDING ACT OF 1987

FRIDAY, NOVEMBER 20, 1987

U.S. SENATE,
SUBCOMMITTEE ON LABOR,
COMMITTEE ON LABOR AND HUMAN RESOURCES,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:02 a.m., in Room SD-430, Dirksen Senate Office Building, Senator Howard M. Metzenbaum (Chairman of the Subcommittee) presiding.

Present: Senators Metzenbaum, Quayle, and Mikulski.

Also present: Senators Specter and Heinz.

OPENING STATEMENT OF SENATOR METZENBAUM

Senator METZENBAUM. Today's hearing is on S. 1811, the Steel Retirement Benefits Funding Act of 1987. This measure was authored by Senator Heinz and myself and is cosponsored by Senators Mikulski, Durenberger, Riegle, Simon, Specter, Sarbanes, and Inouye.

Plagued by unfair foreign competition and outdated plants and equipment, the steel industry has gone through some wrenching spasms in recent years. Unanticipated plant shutdowns forced many workers into early retirement, creating obligations that this cash-starved industry stands unprepared to meet.

Today, the U.S. steel industry is $11 billion short of the amount it needs to keep the promises made to retirees. I do not believe that anyone would disagree that the steel industry, not the Federal Government, has the responsibility to make good on its retiree promises.

But this sizable and growing unfunded debt is pushing many companies over the edge. Wheeling-Pittsburgh, LTV, Sharon Steel, and McLouth Steel companies are now in bankruptcy. They have used the bankruptcy law as a way of alleviating this debt, forcing the Government and retirees to suffer the financial consequences.

It is a process that is unfair to retirees; they lose pension benefits they have earned.

It is unfair to competitors in the steel industry; bankrupt companies gain an unfair advantage with reduced operating costs.

It is unfair to other companies which financially support the Government's pension insurance system, making them pick up the tab for billions of dollars in pension promises.

It is unfair to the communities where these companies reside. LTV's bankruptcy has already cost Cleveland schools $7 million in lost tax revenue.

We must move swiftly to prevent more steel companies from using the bankruptcy courts as a way of bailing themselves out of financial trouble. That is the reason we have introduced S. 1811. The purpose of this bill is to allow steel companies to refinance their obligations. It is intended to accomplish this without increasing the Federal deficit because it uses private, not Government, dollars.

I commend Senator Heinz for his leadership on this issue. As Chairman and Co-Chairman of the Senate Steel Caucus, we have worked together on many issues of vital importance to the steel industry. As always it is a pleasure to work with him, and I am pleased that he has accepted my offer to participate as a member of the Committee and to sit with us today for the purpose of today's hearing.

I believe that working together with industry, with the steelworkers, and with the private sector, we can avert the types of anguish which many of our communities have suffered in the wake of steel bankruptcies. I look forward to hearing today's witnesses.

Senator Quayle, do you have an opening statement?

OPENING STATEMENT OF SENATOR QUAYLE

Senator QUAYLE. Thank you very much, Mr. Chairman.

A vigorous and competitive American steel industry is vital not only for the American economy, but also for our national security. Prudent steps to achieve this objective deserve the support of all Senators.

As concerns over the steel industry increase, Congress often turns to corrective legislation such as S. 1811 in the hope that such measures will be a potent remedy to adverse changes in the industry.

I certainly commend Senator Heinz, Senator Metzenbaum, and other cosponsors for developing this proposal designed to enable the steel industry to surmount some of the barriers to its restructuring as an up-to-date world-competitive industry. This bill provides the industry with access to capital at rates it cannot otherwise obtain.

I am not in general a proponent of Government intervention. In matters of trade, pensions, and bankruptcy, Federal policy intrudes into the way steel companies do business. This type of Federal intervention has been going on for years, and the situation has not improved.

A large part of Government intervention takes the form of the PBGC's underwriting of defined benefit pension plans. In combination with the Bankruptcy Code, the two interact to provide a Federal subsidy to steel producers who do not fund their pension plans and who seek reorganization. Not only do we give these producers a Federal subsidy when the PBGC takes over their pension plans; that subsidy results in an unfair cost advantage for their steel over that of their competitors.

S. 1811 is an improvement over current law because it gives steelmakers an alternative to the route taken by bankrupt steel companies. But this bill is no panacea for the problem that steelmakers face. Those problems are more vast than can be solved by a single fix to steel pension plans.

It would be inappropriate for the Federal Government to attempt to address all the problems of the steel industry; although we should deal with the problems of the steel industry in their totality, we can address the specific problem that plant shutdown benefits present to the steel producers. This is the aim of S. 1811.

If the Federal Government is to intervene further into the internal workings of the steel industry, care must be taken to limit costs to the taxpayers and additional burdens to the Federal budget.

I have a number of reservations about the pending legislation which I shall pose to the witnesses. S. 1811 is a radical departure from past proposals of its kind, particularly in terms of size and scope.

Some of my questions include: One, this bill provides financial assistance for all steel companies regardless of their financial condition or funded status of their pension plans. What is the appropriate criteria for Federal support? Should Federal assistance be related to specific economic conditions? Should assistance be targeted to firms that meet specified standards? If we are to remedy the inequities created by the interaction of the PBGC guaranty and Chapter 11 filings, shouldn't we relate assistance to those inequities?

Two, the bill measures assistance by benefits provided as a result of shutdowns that have occurred in the past. If further restructuring is needed for a viable industry or company, shouldn't assistance be related to meeting that need?

Three, the bill is premised on the steel corporation's transfer of assets to the Authority in return for the Authority's assumption of liability for shutdown benefits. Under the bill as written, different steelmakers could transfer assets of value different from those of their marketplace competitors. How important is it to have standards for the relationship between the value of assets and liabilities transferred?

Four, the bill suggests that general revenues may be available to support the program. Is that prudent? What is the potential impact of Federal loan guarantees such as those contained in S. 1811 on the Federal budget? What is the best estimate of the effect on the Federal budget of defaults under the program?

Five, I have been told that the Government could actually make money if steel stocks appreciate in value due to this program. How can the Federal Government retain enough stock in the transferred assets to make a profit, assuming stock values go up, and still have enough cash to make required payments to the steel companies?

Six, in future shutdown situations, employees are entitled to existing shutdown benefits pursuant to collective bargaining agreements. S. 1811 requires an additional agreement to permit the company to transfer liability for new shutdown costs to the Authority. What is the anticipated quid pro quo for the additional agreement?

The steel industry is in the midst of an extended financial crisis. Compounding trade and consumer demand fluctuations, steel companies have faced extraordinary costs in reducing capacity. In fact, exit fees in the form of plant shutdown benefits and other labor costs are so high that plants remain open even after they have ceased to cover their full cost of production.

The present system of Government intervention provides an incentive for plan terminations which relieve steel producers of the significant cash burdens. The Chapter 11 reorganizations of the Wheeling-Pittsburgh, LTV and other steel companies have shown both the competitive inequities and the human costs of addressing the industry's problems through Chapter 11.

I look forward, Mr. Chairman, to working with you, Senator Heinz and others as we get into this issue, but I do believe that there are some concerns and questions that hopefully will come out from today's witnesses, and that we will have a presentation of the steel industry which will be somewhat divided, which is not totally unexpected. But I look forward to the testimony and working with you in the future on this legislation.

Senator METZENBAUM. We look forward to working with you, Senator Quayle.

We are very delighted that Senator Mikulski, a Member of this Committee and one of the cosponsors of the bill, is with us this morning.

Senator Mikulski.

OPENING STATEMENT OF SENATOR MIKULSKI

Senator MIKULSKI. Thank you very much, Mr. Chairman, for holding this hearing on this important piece of legislation.

I would like to welcome a fellow "smokestack" Senator, Senator Heinz, who also authored this legislation and is active in the Steel Caucus.

As a cosponsor of the Steel Retirement Benefits Funding Act, I am delighted that you are having this hearing, because retirees have worked hard to insure and to pay for their retirement. Workers have a right to expect what they have worked for so hard to be there when they retire.

I do not like to see companies denying retirees their benefits for whatever reason—economic hardship, trade problems, and so on, included.

As we look forward to the year 2000 and plan for the work force of the future, we must also look at the needs of those leaving and those who have left the work force. This bill is designed to address a very serious problem in the U.S. steel industry which must be corrected now to protect the future of the steel industry, its workers and its retirees.

Steel is important. Steel is important to me and to Maryland, and steel is important to the United States of America. Steel has always been the flagship for American manufacturing. It was big steel that helped big America fight the war during World War II. And when I think of my own hometown of Baltimore, Bethlehem Steel once employed thousands and specialty steel companies like Armco proudly flew the flag of "P" for productivity during World

War II. Those same workers are now nearing the retirement age, and they feel they should get what they worked for.

Steel is important to me and to Maryland because we are a smokestack State, whether it was the big steel of Bethlehem Steel or the smaller factories and so on. It was steel that provided jobs. It provided jobs for black Americans, ethnic Americans. It was working in that industry that enabled people to come to America and work their way up in America. And they put in a full day's work, expecting a full day's pay, and when tough times came, they were willing to negotiate.

We know that steel in America now is at a critical juncture. We know they have been hard-hit by a variety of problems—unfair imports being one, excess capacity being another. But we should not place the burden of failed and flawed trade policies and inadequate planning on the workers that made steel great. We profited off steel, and those who helped create those profits now ought to have some type of guarantee that the pensions they worked for would be there.

I think that this legislation offers a unique opportunity to keep our commitment to the American worker and also keep our faith in the responsibilities incurred.

Thank you, Mr. Chairman, and we look forward to passing this legislation.

Senator METZENBAUM. Thank you, Senator Mikulski.

I think your references to the importance of steel brings to the Chairman's mind a thought that I have expressed previously, and that is no matter what you feel about the steel industry, whether you have some concerns about the present or past leadership, whether you have some concerns about the workers, whatever you may feel, this country could not afford and could not exist without a steel industry. You could have a $300 billion defense budget, but if you do not have a steel industry, and you had to import all your steel from Korea or from Taiwan or from Japan or from Canada, we would be defenseless.

So you could get along without an auto industry—I do not want to—and you could get along without many other industries in this country, which I don't want to, but you could not get along, you could not be the pre-eminent power in the world today without having a viable steel industry. So we cannot afford, no matter what our concerns are, no matter what our feelings are, to let the steel industry go down the drain, and we must extend ourselves to see that it continues as a viable part of our economy.

We are happy to have you sitting with us today, Senator Heinz, as the author of the bill and with many of us as co-authors. Do you have an opening statement you would like to make?

OPENING STATEMENT OF SENATOR HEINZ

Senator HEINZ. Mr. Chairman, I do. I will be brief, because I know we want to hear from our witnesses.

Let me commend and thank you for holding the hearing. I particularly appreciate the opportunity to sit in on this hearing and to make an opening statement.

I think that it should be obvious to everybody that in addition to the benefit overhang of some $11 billion in the steel industry, we face a particularly urgent and serious problem with steel industry pensions. Nearly $6 billion in unfunded liability sits out there in the steel plans, and most of it is guaranteed by the Pension Benefit Guaranty Corporation.

A recent rash of steel industry bankruptcies, pension plan terminations, has robbed retirees of promised benefits and is jeopardizing the financial solvency of the Pension Benefit Guaranty Corporation.

There is a real danger that more companies will follow. Steel industry pension plans are in fact the bulk of PBGC's troubled financial position today and for the foreseeable future.

What we need is a creative solution to the steel pension problem, and we need it, in my judgment, this year. And PBGC's game of "hot potato" with LTV over their $2.3 billion in unfunded liability could end up with the PBGC holding not only this "hot potato" but a whole bagful.

Legislation to toughen pension funding rules recently approved by this Committee and the Finance Committee and supported by the Administration could make matters worse for troubled steel companies. The Finance Committee's combination of larger and more frequent pension contributions, huge PBGC premiums, and springing liens would greatly increase the cash demands on companies with underfunded plans at the same time as it would dry up access to capital markets. It seems to me that the Administration's approach is to play Russian roulette with the steel pension liabilities and hope that we do not get the bullet.

S. 1811 is our effort to fill this policy void. It is a proposal to make it possible for steel companies to meet their own obligations to their retirees without being forced to dump their plans on the Pension Benefit Guaranty Corporation and cut benefits. The bill would immediately improve the funding of steel pension plans; it would make it possible for the companies to comply with tougher funding standards so the plans could reach full funding more rapidly, and it would retire the crippling shutdown liabilities within a decade.

Mr. Chairman, if we do not pass legislation of this kind, I would predict that there are going to be some very serious casualties. We understand that those casualties are going to be in the steel industry first and foremost—the companies, the workers, the retirees.

The second biggest casualty is going to be the Federal Government. The Pension Benefit Guaranty Corporation is going to be left holding a bagful of empty promises.

The only beneficiaries of our failure to act would be foreign steel producers, because the only people who would be left in this industry would be one or two steel producers who cannot possibly meet United States steel demands. As a result, what will happen is the steel industry will not only whither away, it will be replaced by foreign steel producers. Those in the steel industry who think that as steel companies go into Chapter 7 liquidation the resolve of Congress will be strengthened to protect them with greater import restrictions will find no constituency left for those import restrictions because there will be no steel industry left, no steel workers left,

no steel retirees with any income security based on the performance of steel companies left to go and make the case for that kind of proposal.

So, Mr. Chairman, I thank you. I appreciate the opportunity to discuss this proposal, and I look forward to hearing from our witnesses. And I hope above all that they understand the seriousness of the problem, and if they do not like S. 1811, that they come forward with some constructive alternatives to it.

Senator METZENBAUM. Thank you.

I see that Senator Specter has joined us. Senator Specter, do you want to make an opening statement?

OPENING STATEMENT OF SENATOR SPECTER

Senator SPECTER. Yes, thank you very much, Mr. Chairman, just a comment or two.

First, let me commend you, Mr. Chairman, for scheduling these important hearings and commend my colleague, Senator Heinz, and you for coauthoring this very important piece of legislation.

The issues on the Pension Benefit Guaranty Corporation are very complex and very, very important. It is really indispensable that some solution be found to the problems facing the Pension Benefit Guaranty Corporation and also to steel companies which are struggling with Chapter 11 and with the intense pressures caused by this problem.

The issue with LTV, Sharon Steel, and Wheeling-Pittsburgh are only illustrative. It is a very complicated issue, as I can personally attest, having met many constituents from the steel industry both here in Washington when they have come, and you and the three of us and others were out in the freezing cold on the Capitol grounds here last year, and being in Aliquippa and in the Monn Valley and hearing the tremendous problems of those who are trying to keep body and soul together and do not have adequate pensions, and then the interrelated problems of the companies which are not in Chapter 11 and the competitive factors which have to be considered from those who are not in the situation of LTV or the problem of Sharon Steel. It is a matter of enormous magnitude. Bethlehem Steel has problems. I was in Bethlehem, Allentown, last Monday and talked to many people there on these issues, and it is a major national concern, crying for an answer. I am optimistic that this legislation is on the right track, and I certainly commend those who are trying to solve the problem in this Subcommittee for tackling the issue, and I appreciate the opportunity to be present briefly.

I cannot stay, because the Intelligence Committee is meeting, but I wanted to come and lend my words of support to this matter.

Thank you.

Senator METZENBAUM. Thank you, Senator Specter. We are very pleased that you are a cosponsor of this legislation.

After the witness list was finalized, Inland Steel asked to present oral testimony. Because of the length of the witness list, we were unable to accommodate Inland. But we will include its written testimony in the record. The testimony raises some constructive suggestions. Inland urges the Committee to require a fair market valu-

ation for the assets transferred to the Authority. I share their concern, and I stand prepared to work with Inland as we move forward with this bill.

I also have two letters of endorsement, one from Robert McGlotten, on behalf of the AFL–CIO, and one from Dick Warden on behalf of the UAW. Without objection, they will be made a part of the record.

Last, I have received a letter from LTV, applauding our efforts. LTV indicates they stand prepared to work with us to modify the bill to ensure that it will qualify to participate in this program. Without objection, that letter will also be included in the record.

[The statement and letters referred to follow:]

Statement of Inland Steel Industries, Inc., Chicago, Illinois

on

S. 1811 The Steel Retirement Benefits Funding Act of 1987

Labor Subcommittee

U. S. Committee on Labor and Human Resources

Hearing

November 20, 1987
Washington, D.C.

In 1986, Inland Steel Company was the fourth largest domestic steel company, based on tons shipped. Inland's corporate headquarters is located in Chicago, Illinois, and its one steel producing facility, the Indiana Harbor Works is located on Lake Michigan in East Chicago, Indiana. That plant is the largest in the United States, with a capacity to produce 6.5 million raw steel tons per year.

Inland Steel believes its interests can be impacted significantly by S.1811, The Steel Retirement Benefits Funding Act of 1987. Inland Steel is a "Qualified Steel Corporation" under Section 6 of that bill and maintains pension and employee welfare benefit plans which would permit Inland to participate in the proposed Steel Retirement Benefits Program. Inland also competes with other steel companies that may be able to obtain competitive advantage from the proposed program.

Inland Steel's assessment of the proposed program is influenced by the sound financial conditions of the Company and the Company's pension fund. Although Inland incurred severe financial losses during the four years 1982-85 and suffered downgradings of company securities to below investment grade, the Company has managed to maintain reasonable access to private capital markets. In fact, over the past five years the Company has sold common stock on three occasions and convertible preferred twice. It has undertaken the sale of both secured and unsecured fixed income obligations and arranged major project financings. In addition, adequate bank liquidity has been available to the Company. The Inland Steel Industries pension plan is well funded even following the recent stock market crash. Even valuing fund assets at the October low, no funding would be required for plan year 1988.

Inland Steel believes it is unfortunate that the financial conditions of many steel companies and their pension plans now makes necessary federal legislative assistance as contained in S.1811. We are concerned that such assistance will inevitably help some steel companies more than others, and we believe it is essential that any program that is enacted be as equitable in impact among competing companies as is possible.

Inland Steel believes there are several positive provisions in S.1811: The bill should help prevent steel companies from filing under Chapter 11 and from dumping their unfunded pension liabilities on the U.S. Government. It provides that payments to companies will be made over a ten-year period. This places the availability of funds to the companies reasonably in line with the need for payment of them for employee benefits. The bill requires that the companies first use the funds for certain qualified pension benefits. Once these are met, it permits payments for retiree health benefits but for no other purpose. Finally, it includes provisions for payment for funds received by the participating companies.

Inland Steel has concerns over three aspects of the bill:

First, we believe it is essential that company assets transferred to the Authority be valued at full and fair market. The fair market value of each company's assets transferred to the Authority each year should equal the payments made from the Fund to each company. Furthermore, we believe the Authority should be required to obtain and use independent, private sector expert opinion in valuing each asset.

We are concerned about fair market valuation of these assets because the bill in Section 3(g) only requires that the Authority determine that value is "appropriate, taking into account -

a. the obligations transferred to the Fund under subsection (e) in connection with liabilities of the corporation assumed by the Authority,

b. the need to attract investors in the Fund established under Section (4), and

c. the availability of other sources of funds to the Authority."

This provision does not set out a valuation process or appear to require fair market valuation of each asset transferred by the participating steel companies.

Second, the bill does not provide for unconditional inclusion of employees to be separated in the two years following enactment. The bill provides for payment to companies for benefits for employees separated from service from 1/1/82 to date of enactment; however, it makes conditional on a determination of the Authority whether it will also permit inclusion of employees to be separated in the two years following enactment. Furthermore, it makes such inclusion subject to authorization in a collective bargaining agreement. We are concerned that these provisions may discourage the further rationalization of the industry, an objective which Inland and most observers of the steel business think is desirable.

Third, the bill does nothing to exempt participating companies from Internal Revenue Code Section 382 as modified by the Tax Reform Act of 1986. Briefly, Section 382 imposes a limitation on NOL carryforwards following an ownership change. An ownership change occurs if a corporation with NOL carryforwards issues equity which over a designated period, causes the interest of "5% shareholders" to increase by more than 50 percentage points. If an ownership change is triggered, then usage of a corporation's NOL carryforwards to offset taxable income becomes limited pursuant to a pre-designated formula. It is conceivable that a participant's transfer of equity to the Authority, when aggregated with other corporate stock transactions, would trigger the Section 382 limitation. At the very least, a participant's flexibility or opportunity to enter into

corporate equity transactions outside of S.1811, would be substantially constricted due to the use of equity to satisfy the Authority's requirements. Inland believes that such added constraints on raising capital for steel industry modernization are neither desirable nor intended. We believe that all equity used to satisfy the requirements of the Act should be exempted from the applicability of Section 382.

In conclusion, Inland Steel believes that failure to provide for unconditional inclusion of employees separated in the two years following enactment may discourage further needed rationalization. We also recommend action to address the Section 382 problem in order to encourage participation in the program without subjecting participants to unintended adverse tax consequences.

However, we believe the most serious flaw of S.1811 is the valuation feature. If nothing is done to require the Authority to make a fair market valuation determination for the assets transferred by participating steel companies, Inland would have to oppose this legislation, because, in our judgment, it would represent a thinly disguised bailout for participating steel companies.

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November 19, 1987

The Honorable Howard Metzenbaum, Chairman
Senate Subcommittee on Labor
Committee on Labor and Human Resources
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

The AFL-CIO appreciates the opportunity to present our views to the Senate Subcommittee on Labor on S. 1811, the Steel Retirement Benefits Funding Act. This bill is designed to aleviate the burden that pension benefits present to the basic steel industry by providing a refinancing mechanism for shutdown pension benefits, i.e., benefits which are triggered by an external event such as a plant closing or layoff of a certain group of employees.

The steel industry has been undergoing major restructuring at a time when the acceleration of steel imports has greatly diminished the industry's capacity to adjust to the serious problems resulting from this restructuring. The result has been serious disruptions including plant closings and bankruptcies of steel corporations.

As a result, workers have lost expected pension benefits because plan assets were insufficient to provide for the shutdown benefits called for in their plan. Neither prior funding nor PBGC guarantees were adequate to protect these benefits. Such bankruptcies inflict grievous harm on workers and their communities.

The pension legislation now pending in Congress will not help steel industry plans which are underfunded or steel companies which are experiencing financial problems. In fact, some features of this legislation, by placing major funding and premium increases on companies with underfunded plans, would make the problems worse and force more companies into Chapter 11 bankruptcies to deal with their financial difficulties.

The Steel Retirement Benefits Act of 1987 would do much to resolve these problems by establishing an authority which would provide cash to the pension plan to pay shutdown benefits in exchange for employer assets (debt or equity) of equal value. The authority would raise the required money by selling shares in a fund consisting of steel company assets and federal securities. These securities would be redeemed over a 10 year period by the increase in the value of the assets and the liability for shutdown benefits would thereby be eliminated. Thus, the companies would likely continue their plans instead of terminating them and the obligation for these benefits would remain with them.

The end result would be that the pension benefits of workers would be better protected, steel employers would not be under pressure to dump pension benefits to remain competitive, and the financial burden on PBGC would be reduced.

The steel industry is undergoing a major restructuring and the labor movement and the entire nation has a major stake in its success. S. 1811 would do much to assure this result. It is essential legislation and should be enacted into law.

Sincerely,

Robert McGlotten, Director
Department of Legislation

c: Members of Labor Subcommittee

INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE & AGRICULTURAL IMPLEMENT WORKERS OF AMERICA—UAW

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November 19, 1987

The Honorable Howard Metzenbaum
Chairman, Subcommittee on Labor
Committee on Labor and Human Resources
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

We understand that the Subcommittee on Labor of the Senate Labor and Human Resources Committee will be conducting a hearing on Friday, November 20 on the proposed "Steel Retirement Benefits Funding Act of 1987" (S. 1811). The UAW strongly supports this bill, and urges the Subcommittee to give prompt, favorable consideration to the legislation.

The steel industry has been facing serious economic difficulties for some period of time. The long-term solution to these problems must involve steps to deal with the unprecedented trade and budget deficits facing this country.

In the short term, however, there is an urgent need for legislation which will address the crisis associated with funding the pension and retiree insurance benefits in the steel industry. In the last several years, a number of steel companies, including Wheeling Pittsburgh and LTV Corporation, have filed for bankruptcy. One of the major factors behind the decision of these companies to file for bankruptcy was a desire to evade responsibility for funding their pension and retiree insurance benefits, and to thereby obtain a competitive advantage over other steel companies. As a result of these actions, the retirement security of thousands of workers and retirees has been jeopardized. In addition, due to the termination of the LTV and Wheeling Pittsburgh pension plans, the Pension Benefit Guaranty Corporation (PBGC) has had to assume responsibility for over two and one-half billion dollars in unfunded pension liabilities. This has severely strained the financial condition of the PBGC and threatened to undermine the retirement security of workers and retirees throughout the country.

The proposed "Steel Retirement Benefits Funding Act of 1987" (S. 1811) would help to address these problems. The bill would provide assistance to steel companies in refinancing certain early retirement pension benefits which are typically triggered by plant closings. In return, the steel companies would have to agree to continue to fund their pension and retiree insurance plans. The steel companies would also be required to provide equity, stock warrants or other assets in exchange for this

financial assistance. This legislation would assure the continuation of pension and health insurance benefits for thousands of workers and retirees in the steel industry. In addition, it would help to prevent the termination of additional pension plans and the transfer of more unfunded pension liabilities onto the PBGC (and indirectly onto other employers who pay premiums to finance the PBGC). Finally, the legislation would establish a mechanism to facilitate the orderly downsizing of the steel industry, without the disruption and hardship which results when companies file for bankruptcy.

For these reasons, the UAW urges the Members of the Subcommittee on Labor to support the proposed "Steel Retirement Benefits Funding Act of 1987" (S. 1811). We ask that this letter be made part of the hearing record. Thank you.

Sincerely,

Dick Warden
Legislative Director

DW:mjk
opeiu494
cc: Members, Subcommittee on Labor
Committee on Labor and Human Resources

The LTV Corporation

November 19, 1987

The Honorable Howard M. Metzenbaum
United States Senate
140 Russell Senate Office Building
Washington, D. C., 20510-3502

The Honorable John Heinz
United States Senate
277 Russell Senate Office Building
Washington, D. C., 20510-3801

Dear Senators Metzenbaum and Heinz:

As you commence hearings on S.1811, the "Steel Retirement Benefits Act of 1987," The LTV Corporation wishes to be on record in support of efforts to address the problems and costs attendant to restructuring and rationalizing the steel industry. However, LTV has problems with S.1811 in its present form. Nonetheless, we applaud your efforts to deal with the pension costs involved in plant shutdowns. As you continue your work in this area, we urge the Congress and the Administration to broaden its focus to the other major cost impacts of downsizing the domestic steel industry.

We have examined S.1811 in detail. As the legislation is currently drafted, retirees from LTV Steel Company who retired early because of plant shutdown or other work-force reductions, would not qualify for coverage under the bill. We are currently in the process of trying to develop changes and modifications to the legislation which will permit LTV retirees to participate in the benefits and security the legislation provides. We will continue our discussions with your staffs and other affected parties to accomplish this end.

Sincerely,

Harold V. Kelly
Director,
Federal Relations - Steel

HVK:lmb

Senator METZENBAUM. Our first witness today is Mr. Dennis Whitfield, Acting Secretary of the Department of Labor. We are happy to welcome you. We have a 5-minute rule, and we hope to be able to conclude this hearing by 12 o'clock today, Mr. Whitfield, and I hope that will not be an imposition on you.

And I notice that you are accompanied by Kathy Utgoff, the head of the PBGC, and I want to say to Kathy Utgoff that I apologize. I had two appointments with you recently, and it was not personal, but I am sorry that I just was not able to make them. Please, let's make them again.

I think you are also accompanied by Chuck Sethness of Treasury, and David Walker, the Assistant Secretary of Labor for Pension and Welfare Benefits.

We are happy to welcome all of you here this morning.

Mr. Whitfield, please proceed.

STATEMENT OF DENNIS WHITFIELD, ACTING SECRETARY, U.S. DEPARTMENT OF LABOR, WASHINGTON, DC, ACCOMPANIED BY KATHY UTGOFF, PENSION BENEFIT GUARANTY CORPORATION; CHUCK SETHNESS, U.S. DEPARTMENT OF THE TREASURY, AND DAVID WALKER, ASSISTANT SECRETARY OF LABOR

Mr. WHITFIELD. Thank you, Mr. Chairman.

I have a short summary statement and a written submission for the record as well. I believe that you and your colleagues agree with me and the Administration on at least two things. One, this is a very complex subject; and two our underlying responsibility in Government is to do what we can to ensure that those who have worked throughout their careers to earn these pension retirement benefits do receive them.

Unfunded pension liabilities of steel companies that have filed for bankruptcy have caused wrenching problems for steel workers, the steel industry, and the Government. In discussing these issues this morning, I would like to touch upon three topics—first, the Administration's analysis of the steel industry and its pension plans; second, the Administration's position on S. 1811; and third, the Administration's alternative to S. 1811.

The Administration has considered the problems of the steel industry at great length. In mid-1986, the Economic Policy Council (EPC) established a working group under the direction of Bruce Smart to thoroughly analyze the condition of the integrated steel industry. On the basis of Mr. Smart's report last spring, the EPC formed a working group under the leadership of Bill Brock and myself to explore solutions to the industry's pension problems. We looked at ways to provide relief to the industry so that companies would not resort to Chapter 11 of the Bankruptcy Code to reduce pension liabilities by transferring pension costs to the Government.

The EPC considered providing direct assistance to the steel industry. However, recent improvements in the condition of the industry just underscore the risk of such Government intervention. A year ago, utilization rates were low, and the consensus was that capacity must be reduced. Now, utilization is quite high. A year ago, most integrated producers were losing money; now they are profitable.

The Administration concluded, however, that the fundamental problems in ERISA that contributed to this situation had to be resolved. This includes the need to strengthen minimum funding standards. In this regard, we believe that the special pension funding problems of the steel industry can be addressed through carefully designed transition rules.

With that background, I will now turn to our analysis of S. 1811.

The Administration does not believe that S. 1811 offers a solution to the pension problems facing the steel industry today. Mr. Chairman, when S. 1811 was introduced the objectives for the bill were outlined; we agree with those objectives. However, we do not think that the legislation will achieve them.

For example, this bill is intended to reduce the risk to the PBGC and therefore the potential cost to the Federal Government. In fact, S. 1811 does not necessarily reduce the risk to the PBGC. It would require the Government to pay for benefits that it does not now guarantee, and it subsidizes companies with well-funded plans that may never turn to the PBGC for assistance. No one knows how much S. 1811 will cost the taxpayer because the legislative language leaves so many important issues unspecified. Thus the expected budget impact cannot be estimated reliably. For example:

Will the Authority pay for benefits related to future shutdowns?

How much will the steel companies have to put up for a dollar of Federal assistance?

Those who say that S. 1811 will cost the Government nothing assume that the steel securities will appreciate in value. But if they do not appreciate, the cost to the Government could be in the billions.

In a nutshell, S. 1811 creates a Federal Authority that would enter into a complex arrangement to provide financing to qualified steel companies at below-market rates. Steelmakers will be entitled to subsidized borrowing because taxpayers would be responsible for defaults on the bonds sold to the Authority by the steel companies.

Another objective of the bill is to make steel companies pay for commitments to their retirees. In the case of default, however, the Federal Authority would assume the benefit payment liabilities, and the obligations issued by the Authority would be direct obligations of the United States.

This bill also fails to level the playing field. It would provide greater subsidies to companies that are now less creditworthy because they have not funded their pension plans. This could discourage troubled companies in other industries from funding their pension plans because they would believe the Government would stand ready to bail them out. This is not the appropriate signal to send when we are trying to strengthen the pension system.

In addition, the Administration has several concerns about the financing mechanism in S. 1811, which are detailed in my written statement.

As I said earlier, the Administration agrees with the objectives of your legislation. We believe that a better way to achieve them, however, is through the pension reform legislation that is now part of budget reconciliation. We acknowledge the special pension problems of the steel industry, and support addressing them through transition rules. The special transition rule for the steel industry

included in budget reconciliation offers substantial relief to the steel industry.

Senator METZENBAUM. How much more do you have, Mr. Whitfield?

Mr. WHITFIELD. About a minute. May I continue?

Senator METZENBAUM. Yes.

Mr. WHITFIELD. While new stringent minimum funding standards are clearly needed, they should not be so burdensome that they would force unnecessary plan terminations. These reforms also address the underlying weaknesses in the pension system, thereby preventing this situation from recurring.

For example, two of the four pension bills in budget reconciliation would restrict plan terminations in Chapter 11. This would make Chapter 11 less attractive and therefore less likely.

The pension reform bills also protect the Government and help to level the playing field by gradually bringing all pension plans up to a reasonable level of funding.

In closing, Mr. Chairman, let me reiterate that the Administration is opposed to S. 1811 for the following reasons. First, no one knows how much it will cost; that alone makes it an ill-advised piece of legislation. Second, it does not reduce the risk to the PBGC; in fact, it increases the Government's exposure. Finally it does not level the playing field because it rewards those who have not funded their pension plans at the expense of those who have.

This concludes my verbal statement, Mr. Chairman.

Senator METZENBAUM. Thank you, Mr. Whitfield.

[The prepared statement of Mr. Whitfield follows:]

STATEMENT OF
DENNIS E. WHITFIELD
DEPUTY SECRETARY OF LABOR
BEFORE THE
SUBCOMMITTEE ON LABOR
OF THE
COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENATE

November 20, 1987

Mr. Chairman, I am grateful for the opportunity to appear before your Subcommittee today to discuss the important and complex issue of retirement benefits in the steel industry. Unfunded pension liabilities of steel companies that have filed for bankruptcy have caused wrenching problems for steel workers, the steel industry, and the government agency that insures pension plans.

This morning I would like to touch upon three topics: (1) the Administration's analysis of the steel industry and the funding status of its pension plans; (2) the Administration's position on S. 1811; and (3) the Administration's alternative to S. 1811.

The Administration's Analysis of the Steel Industry

As you know, the Administration has considered the financial problems of the steel industry, and its special pension problems, at great length. In mid-1986, shortly after LTV filed for protection under Chapter 11 of the Bankruptcy Code, the Economic Policy Council (EPC) established a Working Group under the direction of Bruce Smart, Under Secretary of Commerce. The mission of this group was to thoroughly analyze the condition of the integrated steel industry. Working Group

members talked to steel company officials, union leaders, Wall Street analysts, academics, and others knowledgeable about the industry.

On the basis of Mr. Smart's report last spring, the EPC formed a Working Group under the leadership of Bill Brock and myself to explore pension-based options. In particular, this Working Group explored possible ways in which pension relief might be provided to the industry so that companies would not have to resort to Chapter 11 to reduce their pension liabilities while at the same time ensuring that the cost to the government would be less than might be the case under current law.

At the time that we began our work the steel industry was operating at very low levels of capacity utilization and in an extended financial crisis, having lost $12 billion during the period 1982-1986. Our second largest integrated steel producer had filed for Chapter 11 protection, and the probability that others would follow suit was considered high by industry analysts. Pension plans of the integrated steel producers were underfunded by a total of roughly $6 billion. In the course of this review, it became clear to us the current structure of our pension and bankruptcy laws creates an incentive for companies to reduce their liabilities by dumping their pension plans on the PBGC.

In reviewing the appropriate course of government action, the EPC considered industry-specific assistance. However, recent improvements in the condition of the steel industry

underscore the risk of government intervention. A year ago, utilization rates were low and the consensus was that capacity must be reduced. Now capacity utilization is quite high. A year ago most integrated steel producers were losing money. Now they are profitable. Government action would not have helped and might have interfered with steel industry progress.

The Administration did conclude, however, that the fundamental problems in ERISA that contributed to this situation needed to be solved. This includes the need to strengthen the minimum funding standards. In this regard, it was our judgment that consideration could be given to the special pension funding problems of the steel industry through transition rules.

With that background, let me now turn to our analysis of S. 1811.

Administration Position on S. 1811

Based on considerable background and the experience we have developed over the last 15 months, the Administration does not feel that S. 1811 offers an acceptable solution to the pension problems facing the steel industry.

S. 1811 creates a Federal Authority that would enter into a complex arrangement to provide financing to qualified steel companies at below-market rates. These low interest rates would be available to steel companies because the obligations created by the new Authority would be backed by the full faith and credit of the United States government. In other words, steelmakers would be entitled to subsidized borrowing because

taxpayers would be responsible for defaults. The funds borrowed at below-market rates would be used to reduce unfunded pension obligations. In substance then, S. 1811 transfers a sizeable fraction of the responsibility for underfunded steel plans to the taxpayers.

Mr. Chairman, when S. 1811 was introduced, the objectives for the bill were outlined. Although the Administration agrees with those objectives, we do not think that the legislation will achieve them. For example:

One objective is to: Reduce the Pension Benefit Guaranty Corporation's (PBGC's) risk from underfunded steel pension plans and thus reduce the potential cost to the Federal Government. S. 1811 does not necessarily reduce the risk to the PBGC. In addition, it does nothing to restrict the ability of steel companies who participate in the program from dumping unfunded pension liabilities on the PBGC. It would have the government pay for benefits that are not guaranteed by the PBGC, and would subsidize steel companies that may never make a claim against the government. For these reasons, S. 1811 could add to the huge costs already borne by the Federal government through the PBGC.

The second objective is to: Make steel companies pay for commitments to their retirees. In S. 1811 participating companies are not necessarily required to pay for their pension commitments since the Federal Authority would assume benefit payment liabilities and the obligations issued by the Authority would be "direct obligations of the United States."

With respect to equities within the steel industry, S. 1811 would provide greater subsidies to companies that are now less creditworthy because they have not funded their pension plans. The bill does not lead to better results among competitors because subsidy amounts are unequal. Moreover, this bill could discourage troubled companies in other industries from funding their plans because they will believe the Government stands ready to bail them out. This is not the signal to send when we are trying to strengthen the private pension system.

A third objective is to: Prevent future Chapter 11 bankruptcy filings by steel companies. Because a company would still be able to enter Chapter 11 and terminate its pension plan, and thereby shift liabilities to the PBGC, the bill would not prevent, or necessarily deter, Chapter 11 filings. In contrast, two of the four pension bills that are part of the reconciliation package would restrict pension plan terminations in Chapter 11 reorganization.

The fourth objective is to: Maintain current pension benefits and health plans and protect the benefits of retirees. S. 1811 does meet this objective, but only by shifting substantial risk to the taxpayer. No one knows how much S. 1811 will cost the taxpayer. Even the proponents of the bill are unable to estimate its expected budget impact. The legislative language leaves many important issues unspecified. For example, the value of securities that a steel company is required to transfer in return for a dollar of Federal government assistance is left open. Some say that S. 1811 will

cost the government nothing. This assumes that steel securities will appreciate in value. If steel securities do not appreciate in value, there will be a cost to the government, which could be substantial.

In addition, the Administration has several concerns about the financing mechanism in S. 1811.

First, the intent of the bill appears to be to establish an off-budget mechanism for the retirement benefits. Second, the proposal appears to create a new fully-backed government security that would compete in the market with Treasury securities. Finally, the Authority would be authorized to receive funds from "any other source," which may be an oblique reference to appropriations. Thus, the intent of the bill appears to be to circumvent the normal appropriations process and to avoid budget scoring.

In summary, Mr. Chairman, the Administration strongly opposes S. 1811.

The Alternative to S. 1811

As I stated earlier, the Administration agrees with the objectives of your legislation. However, we believe that a better way to achieve them is through pension reform legislation that is now part of the reconciliation process. This legislation will address underlying weaknesses in the pension system, thus preventing this situation from recurring. We also acknowledge the special problems of the steel industry and propose to address them through transition rules for steel.

The special transition rule for the steel industry that is included in two of the four bills in reconciliation offers substantial relief to the steel companies. Specifically, the transition rule requires that the funded ratio of the steel plans increase by 1% annually for five years, at which point the generic minimum funding standards will apply. Savings would vary depending on the individual funding status of each company's plan.

Two of the four pension bills that are part of the reconciliation package would restrict pension plan terminations in Chapter 11 reorganization. The elimination of the Chapter 11 basis for plan termination would make Chapter 11 less attractive and, therefore, less likely. In Chapter 11 proceedings that do occur, workers' pension rights would be paid in full unless the company could demonstrate that the plans had to be turned over to the PBGC in order to preserve the company.

The pension reform bills would also protect the government and help to level the playing field in the steel industry by increasing PBGC's recovery from companies that terminate underfunded pensions and by gradually bringing all steel company pension plans up to a reasonable level of funding. While new, more stringent minimum funding standards are clearly needed, they should not be so burdensome that they would force unnecessary plan terminations. This is why the Administration supports transition rules for the steel industry, such as those in the House-passed pension reform bills.

In closing, Mr. Chairman, let me restate the Administration's firm view that the steel industry's pension problems can be addressed through pension reform legislation that reduces the inequities in current law by making companies more responsible for their own pension promises, and not through off-budget solutions.

We are encouraged by the return to profitability the steel industry has recorded during the first three quarters of 1987 after five years of record losses. Now, when Federal borrowing threatens the entire economy, and when the steel industry is recovering, is not the time to fund such a program.

Senator METZENBAUM. The Chair will impose a 5-minute limit on each Senator's questioning period, with additional rounds if necessary.

Mr. Whitfield, your prescription is to force steel companies to pour hundreds of millions of dollars a year into their pension plans. That is a good idea if they have it. At a time when there is a great need to modernize their plants, where is all that cash going to come from? And I point out to you that Armco's 1986 pension deficit is $581 million and growing; its current annual contribution is to be $75 million; their 9 months 1987 net income without tax credit cash-outs was $47 million.

Bethlehem has a $2.5 billion pension deficit and growing; its current annual cash contributions would be $150 million. Its 9-month 1987 net income without tax credit cash-outs is $5.3 million.

I was talking with a couple representatives of the steel industry yesterday. They indicated to me that although the companies are operating at a high productivity level, that is, as compared to capacity, the facts are that they are not making that much money.

I think it is good that they should pay if they have the money. But what do we do if they do not have the money? The implication of driving them into Chapter 7 instead of Chapter 11 is frightening because frankly, I think, as I have earlier said, we cannot afford to run this country without an American steel industry.

Mr. WHITFIELD. Mr. Chairman, our approach would not have that result because we support the transition rule for steel and we are confident that we can get it out of conference.

The transition rules we support and believe we can sustain would provide relief of up to $450 million a year for some of the affected companies. We are cognizant of that problem. We do not want to drive companies into a bankruptcy situation. That is why we strongly support the transition rules for steel.

With that in mind, we have to seek some fundamental pension reform or we could be here next year and in years to come regarding a number of other industries that could face similar circumstances if we do not fix the problems in the pension system today.

Senator METZENBAUM. You point out that the Finance and Ways and Means pension provisions in reconciliation restrict the ability to terminate pension plans to companies in Chapter 7. There are also provisions which attach liens against companies with unfunded pension promises.

Now, I have heard from the banks and the companies who lend and supply products to steel. The fact is that the lien provision will actually prevent steel companies from obtaining credit.

Is it your objective to push the companies to liquidate when they cannot find the cash to pay for the $5 to $8 billion in pension obligations, and what is your constructive program to deal with the steel pension crisis? I am concerned that I don't think anybody wants to just hit the Federal Treasury. On the other hand, I think there is the other side of the scale, and that is how do we save this industry before we wind up with maybe just one or two companies left in the entire industry, and that would certainly not be good for the Nation.

Mr. WHITFIELD. Let me offer a comment and then turn to Dave Walker on a couple of specifics.

Our intent and our goal is to systematically and progressively get these pension plans to the point where they are fully funded or close to being fully funded so there will not be any liens to worry about.

Senator METZENBAUM. How do you do that?

Mr. WHITFIELD. Well, through the transition rules, for one thing.

Senator METZENBAUM. How does a transition rule do that?

Mr. WHITFIELD. Mr. Walker can cover the specifics.

Mr. WALKER. Senator, I would like to address a couple of things you mentioned with regard to the Ways and Means proposal. First, it eliminates Chapter 11 as an automatic qualifier for distress termination. It does not, however, require that a company go to Chapter 7 in order to qualify for distress termination.

It says that merely because you file for Chapter 11, you cannot automatically qualify for a distress termination and shift the liabilities to the PBGC.

There are two other statutory standards for termination that would continue to apply. One is a significant reduction in the work force; the second is a burden to the company so severe that it could not continue to survive in business.

With regard to the liens, the Administration feels that it is important that companies have full accountability and responsibility for the promises they made, as you said earlier in the hearing. The lien provisions that you refer to in the Finance Committee proposal, as I recall, grandfather existing underfunded amounts. Therefore they would deal with your concerns. We feel that that makes sense.

The Finance Committee version also proposes additional security for prospective due and unpaid employer contributions that have not been made. We think that makes sense. While we want companies to be fully accountable for their promises. The Ways and Means bill and the Administration's proposal would still allow companies up to three minimum funding waivers over a 15-year period if they can demonstrate hardship on a controlled group basis.

We think such safety valves are important and appropriate.

Senator METZENBAUM. I am concerned that if you have this automatic lien provision, no bank will lend them any money because the Bank will feel that they stand in the position practically of an unsecured creditor, or at least they are a subordinate creditor. But I will not——

Ms. UTGOFF. Senator, let me just make a comment about that. The Administration only supports provisions affecting matters over which the company has complete control. For instance, if a company fails to make a contribution a lien would arise only if the company made an explicit decision to not put the money in the underfunded plan. We also support flexibility regarding unfunded benefits that arise prospectively so that the company is not adversely effected by something that they now cannot do anything about.

What we are asking for is in the Finance bill—that is a priority equal to a tax claim. As you know, banks lend to troubled steel companies on a secured basis. As the bankruptcy priorities go, there are secured creditors and a list of priority creditors, the last of the priority creditors is a tax lien. Therefore, we would not dis-

place any existing secured creditors nor would these claims arise without the company's control.

We are saying that when a company fails to make a contribution to a pension plan, it is borrowing money from its workers. We ought to treat that seriously. We are asking companies to take such loans seriously and to do it with some probability that the loan can be paid back.

We are not asking to displace any existing creditors.

Senator METZENBAUM. Senator Quayle.

Senator QUAYLE. Thank you very much, Mr. Chairman.

Let me explain my dilemma and hopefully you can lead me through this.

I see that we have a huge underfunding problem in the PBGC, and 80 percent of that underfunding tuning of $6 to $7 billion comes from the steel industry. And there is no doubt that the shutdown costs and the restructuring and the 65 rule and the 80/70 rule all complicate it. They were bargained for, and perhaps they can say they did not anticipate all the shutdown costs, but they were put into the collective-bargaining agreements; men and women sat across at the bargaining table and put this into the contract.

There is no doubt that the retirees, the steel workers, are going to get their money. The question is how this is going to be done and how we are going to live up to that commitment. There is no suggestion that the retirees are not going to get their money.

I am perfectly aware of the transition rule that we have and I think on a short-term basis that that is certainly satisfactory.

My concern is that if we have a downturn in the economy, or a less than anticipated growth rate the transition rules will not be sufficient,

Given that we have a commitment to having a viable, competitive steel industry, my thoughts turn to our possible alternatives.

Are you saying today that the only alternative that we have in dealing with this is a transition rule? I know you are opposed to this specific piece of legislation. I also know that there was a great deal of discussion that went on in the Administration concerning the steel industry, which never really crystallized into a consensus or an Administration position, and that is why we are here today.

And as we consider this issue today are transition rules the only thing you are willing to examine, or are there some other options that might be available to us for discussion purposes on this huge underfunded liability?

Mr. WHITFIELD. Senator, we have asked ourselves that same question over the last year and a half as we have gone through this, and we came back to the primary question: What is the cause of the problem? Why do we have this underfunding? Our response is to fix the problem, that is to fix the system which allowed such underfunding to come about.

The transition rules in this instance are significant. There is potential relief to some companies of up to $450 million over the period of the transition. In addition, we proposed an immediate step, to reduce the incentives for filing a Chapter 11 action. We had a little over $300 million in PBGC liabilities in the first part of 1985 and then wham, wham, wham, suddenly we were at a little

over $4 billion. We had to find a way to address the systemic problems. The approach that we have put forward does that. It does not penalize those who are funded. It sends a message to this particular industry that we have got to change our way of doing business in the pension area. It also sends a message to other sectors, to other industries, that you cannot come to the PBGC, or to the Government or to the taxpayer through Chapter 11, and transfer pension liabilities to the American taxpayer.

Senator METZENBAUM. Are there other industries out there, in your judgment, that are like the steel industry as far as the underfunding capacity?

Ms. UTGOFF. There are other industries that have the same conditions that have proved to be so difficult in the steel industry. One, they are under competitive pressures, and two, more important, they have pension plans where the liability increases enormously because of early retirements.

That is not typical for most pension plans, but it is typical of some, and those are the plans that most threaten the PBGC.

Senator QUAYLE. Which specific industries have this same problem?

Ms. UTGOFF. Well, the automobile industry is another industry that has pension plans very similar to the kind that we find in the steel industry. If there were similar circumstances in the auto industry that prevailed in the steel industry we could have a problem. There are a number of other industries that also are similar that also have underfunding—the rubber, generalized transportation, and the tire industries.

I want to make it clear that there is no industry that is in the significant distress—I would call it real distress—in terms of their pension plans that we find in the steel industry now.

Let me make an additional point. You asked what would happen if things got bad——

Senator QUAYLE. My concern is that I am not completely convinced that this transition rule is going to be the answer. And I am sure that I can propound that question to the steel representatives and the others who will be forthcoming with testimony, and I am confident of what that answer is going to be. What I am trying to do is to ascertain the degree of confidence you have with regard to the effectiveness of the transition rule in this problem.

Ms. UTGOFF. It is not the answer. It is part of the answer. The answer also includes the other changes that we have asked for, which would really address the problem.

If there is a significant downturn and the steel companies cannot afford to keep their pension promises and stay in business, the PBGC stands ready to back up those pensions and protect workers.

We have also asked for legislation to ensure that more of the losses due to plan termination are covered. The bill before this Committee would also do that. Under S. 1811, if the steel companies really cannot keep their pension obligations, the Steel Authority would pick them up.

What we are saying is that under those conditions, we will have to assume responsibility in any event. The PBGC stands ready to do this. We believe that the changes we ask for will make sure that the PBGC is there and financially able to take over these plans.

This is a better alternative. The changes in Chapter 11 are particularly important so that the pension plan is not the first thing to go but is terminated only if the company is really unable to meet their pension obligations and stay in business. Unfortunately, that is not the case now.

Senator QUAYLE. I have one other question. What do you see as the potential cost of the Heinz bill S. 1811, to the taxpayer?

Mr. WHITFIELD. Well, that is the big unanswered question. There is no way, really, to gauge that, because first of all, you would have to assume——

Senator QUAYLE. Treasury can. Go ahead. [Laughter.]

Mr. WHITFIELD. First of all, you would have to assume that over the next 10 years or so, these securities would appreciate. And you would have to estimate at what rate. But there is another source of revenue in this bill, and that has got to be additional Government, taxpayers' money.

Senator QUAYLE. Do you have any estimate of what the potential liability would be in the worst case scenario?

Mr. SETHNESS. The worst case scenario is that it is going to cost the taxpayer 100 percent of the money supplied to the retirees, because the assets——

Senator QUAYLE. Do you mean if they take advantage of the whole $7 billion of outstanding——

Mr. SETHNESS. I do not know what——

Senator QUAYLE. Give me a realistic one. Do you have any realistic figures of what you think it might be?

Mr. SETHNESS. The bill does not say, and I am not sure whether it can be made to say clearly; the offset for the money that the Government is going to put into this is the value that results from whatever is transferred from the steel companies. And there is a list of things in the bill that includes stock and warrants and debt obligations and other assets.

Senator QUAYLE. I am talking about the ultimate cost to the taxpayer.

Mr. SETHNESS. The ultimate cost to the taxpayer is going to be the difference between what the Authority, the steel fund has to borrow to pay retirees and interest on its own borrowings and operating costs less the value of the assets transferred from the steel companies. I do not know what either of those numbers is.

Senator QUAYLE. Do you think there will be a cost to the taxpayer?

Mr. WHITFIELD. I think so. Senator, I think the short answer to your question is somewhere around $5.7 to $6 billion, which could go beyond what the status quo is now.

Senator QUAYLE. To the taxpayers?

Ms. UTGOFF. Yes.

Mr. WHITFIELD. If everything went belly up.

Senator QUAYLE. OK.

Senator MIKULSKI [presiding]. Senator Quayle, before you go for the vote, do you have any questions you wish to submit in writing? Can we protect your right in any other way?

Senator QUAYLE. I am finished, basically, with this panel, Madame Chairman.

Senator MIKULSKI. OK. We wanted to be sure you were taken care of.

Senator QUAYLE. Thank you, and I will be back.

I think Senator Heinz is coming back——

Senator MIKULSKI. We are looking out for Senator Heinz.

Senator QUAYLE. Thank you.

Senator MIKULSKI. I am telling you, the smokestack Senators stick together here.

Senator Heinz is over voting on the confirmation of DOD Secretary Frank Carlucci and should be returning. I am going to be asking a few questions in behalf of him until he returns for himself.

Senator Heinz wanted me to pose this question to you, Mr. Whitfield, and any panelist who wished to comment. He said this:

> A recent American Metal Markets article quoted a PBGC spokesman as saying, "The Administration is in favor of proposals addressing the significant shutdown problem. Shutdown benefits should not be paid from the general pool of assets that pay the basic retirement benefits, but rather, should be paid from a separate fund."

Senator Heinz says S. 1811 does just that, and he would like you to answer: "How do you reconcile this statement with your opposition to separate financing for shutdown benefits in the steel industry?"

Did I do that OK, Senator Heinz?

Senator HEINZ. Well, thank you very much, Senator. Yes, you did. Everybody is speechless.

Ms. UTGOFF. Well, I guess I should answer that since it was attributed to the PBGC. What someone was obviously talking about there was the fact that shutdown benefits arise virtually overnight in some cases and can the very expensive. A pension plan has benefits that need to be pre-funded in order to work. You can estimate when somebody is going to retire and fund his benefits over his working life, but with a shutdown the benefits arise overnight. Combining these two types of benefits in a pension plan, the basic retirement benefits and the shutdown benefits, which are much more like unemployment or severance pay has caused enormous problems.

We had a study for six or eight months, from the actuarial community, and they have come to the conclusion that you really cannot pre-fund shutdown benefits.

The solution that we think needs exploration is to separate out two different kinds of benefits: Shutdown and early retirement benefits from normal pension benefits, in order to make sure that those benefits are better funded and that they are clearly identified in the collective bargaining process and in funding standards.

The bill here would move exactly in the opposite direction by taking them basically almost off the horizon of the people who really have most control over them. We are suggesting that we focus more attention on the cost and funding of shutdown benefits rather than to make it a Government responsibility.

Senator HEINZ. Very well.

Mr. Whitfield, the Administration has stated that the distress criteria for Chapter 11 terminations is a problem for Ms. Utgoff and the PBGC and should be eliminated. Which steel companies have used Chapter 11 distress termination to date, and what differ-

ence would eliminating Chapter 11 as a criteria have made in the case of LTV?

Ms. UTGOFF. Senator Heinz, may I answer that? We have had terminations from about 117 steel companies that represent almost 200 different pension plans. I do not have an exact count, but in general, 80 percent or more of the companies that we deal with are in some kind of reorganization, either Chapter 11, Chapter 7, or some kind of more informal reorganization.

Senator HEINZ. I understand that, but the term "distress termination" is a term of art, and you do not have to declare a distress termination in order to terminate your——

Ms. UTGOFF. Under current law, you must. It is a statutory standard. And when I talk about these plans, I am talking about all the plans that we have terminated. Before the recent amendments to ERISA were passed, you did not have to meet a distress standard. Most of the ones that I am talking about are before the recent changes in the law, which set up the concepts of standard and distress terminations.

Senator HEINZ. So there have been no distress terminations to date?

Ms. UTGOFF. No; there have been. There have been, I think, 25 distress terminations under the new law—not only steel companies.

Senator HEINZ. You are saying in Chapter 11, there have been distress terminations in Chapter 11?

Ms. UTGOFF. Yes, that is the case. I am not sure that they are all steel companies.

Senator HEINZ. My information is different from yours, and further, I do not believe that in the case of LTV, which is your biggest single existing problem, that there was a distress termination when LTV went into Chapter 11.

Is that right?

Ms. UTGOFF. Well, that is not how the pension plan was terminated. They filed for Chapter 11 in July 1986. They missed a funding contribution in September 1986. They had an outstanding waiver for the previous year which was not met. We worked with the company and a number of their people for several months. The company said they could not and would not make the funding contribution. On that basis, the plan was terminated.

Senator HEINZ. Now, Mr. Whitfield, you and the Department of Labor and Bruce Smart and the EPC have studied this entire issue carefully. And when you looked at the problem in 1986, you saw a big problem, and you were worried about it. You said in your testimony a moment ago that as you look at 1987, profitability has improved, and you think the problem has receded.

What will happen if, as many analysts predict, there is a significant downturn in the steel industry next year?

Mr. WHITFIELD. Well, Senator——

Senator MIKULSKI. Could I encourage that you respond to Senator Heinz in a very crisp way? The panel has now fallen behind, but we want to be sure that the Senator from where Bethlehem Steel's headquarters are has time to complete his answer.

Mr. WHITFIELD. Senator, very briefly, not having a crystal ball, we would have to see to what extent the industry faced problems in a year or two years; but there is a consensus within the Adminis-

tration and within the EPC that any initiative undertaken by us, would have to meet several criteria. It would have to include basic pension reforms. Any action taken would have to significantly reduce PBGC losses and restrict the ability to terminate under Chapter 11, and identify any financing or funding source in advance so that we would know where the money would be coming from.

Senator HEINZ. To kind of condense this discussion, let's assume that the profitability returns to the 1986 levels. Now, under the legislation that you have referred to which will, I suppose, attempt to increase pension contributions, what kind of profits or for that matter cash would be left to steel companies?

Mr. WHITFIELD. I don't have an answer for that.

Senator HEINZ. Well, let's take an example. Bethlehem's profits without the investment tax credit were $5.3 million—million, not billion—in the first 3 quarters of 1987. Their annual pension contributions are now $180 million. A 1-percent increase in their funding would cost them an additional $40 million. Without investment tax credits, they would be losing $35 million.

Isn't that the kind of situation we could expect next year if the profitability of the industry continued as it is now?

Mr. WHITFIELD. I would guess, Senator, but you are dealing with a "What if" situation. I do not know how to look 1 or 2 years down the line to say that.

Senator HEINZ. I am not asking you to predict what profits will be. I am just trying to get you to understand what will happen to companies in an industry if there is an economic downturn.

Madame Chairman, I may have some additional questions I would like to submit in writing.

Senator MIKULSKI. The Senator's right to ask those questions in writing is protected and agreed upon, and we would request the panel to answer the Senator's questions for the record, promptly.

Senator HEINZ. I thank the Chair.

Senator MIKULSKI. Thank you very much, Senator Heinz.

Ladies and gentlemen, that really will conclude our listening and questioning on panel one. This panel is excused, and we are now going to move on to Panel 2.

Thank you for your testimony.

We are now going to hear testimony from Lynn Williams, President, United States Steelworkers; Curtis Barnette, General Counsel to Bethlehem Steel; Bruce Johnston, of USX; Kempton Jenkins for Armco, and Stanley Ellspermann, from National Steel.

If we could clear the aisles and move expeditiously, and the members of the panel would come forward.

Gentlemen, this Subcommittee welcomes you because you really represent big steel rather than those who comment on big steel.

I think we are going to start off with the man who represents United Steelworkers, someone who has testified before this panel before, Mr. Lynn Williams.

Mr. Williams, the panel welcomes you, and in the interest of time, because it is really the Q and A that goes to the heart of it, I ask unanimous consent that all testimony of all the witnesses be included in the record as if read. So ordered.

Mr. Williams, if you could confine your remarks to about 5 minutes, we would appreciate it.

STATEMENTS OF LYNN WILLIAMS, PRESIDENT, UNITED STEELWORKERS OF AMERICA, PITTSBURGH, PA; CURTIS H. BARNETTE, SENIOR VICE PRESIDENT, GENERAL COUNSEL AND SECRETARY, BETHLEHEM STEEL, BETHLEHEM, PA; J. BRUCE JOHNSTON, EXECUTIVE VICE PRESIDENT, EMPLOYEE RELATIONS, USX CORP., PITTSBURGH, PA; KEMPTON B. JENKINS, VICE PRESIDENT FOR INTERNATIONAL AFFAIRS AND GOVERNMENT RELATIONS, ARMCO INC., WASHINGTON, DC, AND STANLEY ELLSPERMANN, SENIOR VICE PRESIDENT, NATIONAL STEEL CORP., PITTSBURGH, PA

Mr. WILLIAMS. Thank you very much, Madame Chairperson, Senators. It is a privilege to be here.

The structural changes which have been dramatically affecting stability of the steel industry in terms of capacity retrenchment, product line shifts, sustained periods of financial losses, high levels of import penetration, and severe reduction in manpower, have also had a profound impact upon the private pension system, which for steel was negotiated in 1949 after a long strike.

There are a number of brief remarks which I think are appropriate as supplementary comments to our testimony in support of S. 1811, designed by its authors Senators Heinz and Metzenbaum to preserve the steel pension system.

First, the private system. Of major importance is the fact that the steel pension system is a private sector one, financed by private sector contributions. In most industrial countries, the pension system is entirely a public institution. Despite severe cyclical pressures in the past, the pension system was able to sustain itself. There was always a steel recovery. However, structural pressures are putting the system under serious strain.

Second, shutdown benefits. One of the key benefits is the provision of a full pension and a $400 supplement in lieu of noneligibility for Social Security, payable prior to the normal age of retirement in those shutdowns where there has been a permanent layoff due to a shutdown.

While the present ERISA funding standards were enacted to assure that pension plans would not have large unfunded liabilities in the eventuality of termination and subsequent insurance by the PBGC, many of the steel pension plans succumbed to heavy underfunding because of the enormous amount of shutdown benefits or "exit benefits" which were awarded to laid-off steelworkers during the last 5-year period.

Third, funding standards. The USWA strongly supports the funding of pension obligations. In 1974, it advocated a statutory requirement. Experience has indicated that the minimum funding standards are not adequate and hence, we again support in this Congress a more rapid amortization of the unfunded pension liabilities.

Fourth, Chapter 11. It is the financing of these benefits which in the short term is causing a sharp increase in the funding obligation. If faster funding schedules are adopted by the Congress, the increase in the annual contributions to the pension plans will be

even greater. Hence, some steel companies have felt compelled to enter Chapter 11 bankruptcy to reorganize their debts and terminate their pension plans in order to avoid liquidation.

Fifth, PBGC reinsurance. However, for the retired worker, the termination of pension plans spells chaos. Even though the PBGC does reinsure most pension benefits, it is precisely those "exit benefits" which are not fully guaranteed by the PBGC, and workers can sustain substantial losses in benefits.

Furthermore, for the active worker, the subsequent pension plan is substantially different from the previous plan and is no longer insured by the PBGC. Actually, we may be witnessing the destruction of the defined benefit pension system.

Sixth, shutdown measures. A question could be raised as to whether private pension plans should bear the cost of the shutdown social measures. However, unlike other industrial countries, there is no publicly financed system to provide early retirement options in restructuring shutdowns. It is therefore an obligation which the private pension system could not ignore. But it is also not one which the PBGC is currently equipped to handle.

The union strongly supports the S. 1811 approach because it would provide the worker with better protection than is available under the PBGC. It would relieve the pressure on the steel companies to finance the exit benefits currently, while at the same time, it would hold the companies responsible for the payments over time through the surrender of company assets as a pledge against the cost of the benefits.

It would remove PBGC exposure to further steel pension plan terminations by relaxing the industry's obligation to immediately finance the shutdown benefits. Chapter 11 would no longer be the only option to respond to this pressure. This is an important condition of the Heinz-Metzenbaum proposal—namely, the maintenance in full of the pension program. There is also the requirement that the health care plans also be fully maintained as a quid pro quo for participation in the refinancing arrangement.

It would allow the steel companies to engage in a more comprehensive restructuring program. It should be noted that the bill is neutral is an inducement to additional elimination of capacity and jobs. It is the past exist costs which are causing the financial crisis.

Future shutdowns will be dictated by market conditions and not artificially induced as a result of this legislation. Although the collective bargaining partners could submit to the authority shutdown costs incurred after the effective date of the bill. It is the hope of the union that a comprehensive steel policy will void the necessity for any more collapsing of capacity.

It equalizes the adverse competitive position caused by some companies which use Chapter 11 proceedings to abandon their pension obligations.

The union also wishes to emphasize that the general ERISA reform measures relating to an increase in PBGC premiums and more rapid pension funding rules will not suffice to handle the PBGC's crisis, 80 percent of which is generated by steel terminations. A steel-specific approach is also needed.

We are confronted with a worker adjustment need and a practical PBGC problem. S. 1811 addresses those issues.

Senator METZENBAUM. Thank you very much, Mr. Williams. We are very happy to have you with us this morning.

[The prepared statement of Mr. Williams follows:]

TESTIMONY

of

Lynn R. Williams, President

UNITED STEELWORKERS OF AMERICA

before the

Senate Subcommittee on Labor

on

Steel Retirement Benefits Funding Act
(S. 1811)

November 20, 1987
Washington, D.C.

I. Introduction

The structural changes, which have been dramatically affecting stability of the steel industry in terms of capacity retrenchment, product line shifts, sustained periodc of financial loses, high levels of import penetration, and severe reduction in manpower, have also had a profound impact upon the private pension system, which for steel was negotiated in 1949 after a long strike. There are a number of brief remarks which I think are appropriate as supplementary comments to our testimony in support of S. 1811, "Steel Retirement Benefits Funding Act," designed by its authors, Senators Heinz and Metzenbaum, to preserve the steel pension system.

1. Private System. Of major importance is the fact that the steel pension system is a private sector one, financed by private sector contributions. In most industrial countries the pension system is entirely a public institution. Despite severe cyclical pressures in the past, the pension system was able to sustain itself. There was always a steel recovery. However, structural pressures are putting the system under serious strain.

2. Shutdown Benefits. One of the key benefits is the provision of a full pension and a $400 supplement (in lieu of non-eligibility for social security) payable prior to the

normal age of retirement in those situations where there has been a permanent layoff due to a shutdown. While the present ERISA funding standards were enacted to assure that pension plans would not have large unfunded liabilities in the eventuality of termination and subsequent insurance by the PBGC, many of the steel pension plans succumbed to heavy underfunding because of the enormous amount of shutdown benefits of "exit-benefits" which were awarded to laid off steelworkers during the last 5-year period. Note that these are benefits, the granting of which cannot be predicted and, hence, defy actuarially-based prefunding arrangements. It is estimated that approximately 43,000 steelworkers are drawing these benefits as a result of the sharp reduction in 47 million tons of capacity and over 50% slash in jobs since 1982.

3. Funding Standards. The USWA strongly supports the funding of pension obligations. In 1974, it advocated a statutory requirement. Experience has indicated that the minimum funding standards are not adequate and, hence, we again support in this Congress a more rapid amortization of the unfunded pension liabilities. But it is important to reiterate that a large portion of the unfunded liability in the steel pension plans is due to the "exit-benefits."

4. Chapter 11. It is the financing of these benefits which, in the short term, is causing a sharp increase in the

funding obligation. If faster funding schedules are adopted by the Congress, the increase in the annual contributions to the pension plans will be even greater. Hence, some steel companies have felt compelled to enter Chapter 11 bankruptcy to reorganize their debts and terminate their pension plans in order to avoid liquidation.

5. PBGC Reinsurance. However, for the retired worker, the termination of pension plans spells chaos. Even though the PBGC does reinsure most pension benefits, it is precisely those "exit benefits" which are not fully guaranteed by the PBGC and workers can sustain substantial losses in benefits. Furthermore, for the active worker, the subsequent pension plan is substantially different from the previous plan and is no longer insured by the PBGC. Actually, we may be witnessing the destruction of the defined benefit pension, a system which has served the workers in the steel industry well and one which provides a greater degree of security than other types of pension plans. It is that system which must be preserved.

6. Shutdown Measures. A question could be raised as to whether private pension plans should bear the cost of the shutdown social measures. However, unlike other industrial countries, there is no publicly financed system to provide early retirement options in restructuring shutdowns. It is,

therefore, an obligation which the private pension system could not ignore. But it is also not one which the PBGC is currently equipped to handle.

7. Offloading. The Heinz-Metzenbaum bill addresses this dilemma by providing a mechanism whereby these special exit-benefits could be "offloaded" from the regular pension obligations and subjected to a separate refinancing system through the issuance of bonds. While the refinancing of these benefits remains a private sector obligation, there is, nevertheless, a federal guarantee to the bondholder which provides the financial environment for the refinancing mechanism to work. The union strongly supports this approach because:

-- it would provide the worker with better protection than is available under the PBGC. His benefits will be paid in full since there will be no termination of pension plans;

-- it would relieve the pressure on the steel companies to finance the exit-benefits currently while, at the same time, it would hold the companies responsible for the payments over time through the surrender of company assets as a pledge against the cost of the benefits;

-- it would remove PBGC exposure to further steel pension plan terminations by relaxing the industry's obligation to immediately finance the shutdown benefits. Chapter 11 would no longer be the only option to respond to this pressure. This is an important condition of the Heinz-Metzenbaum proposal--namely, the maintenance in full of the pension program. There is also the requirement that the health care plans also be fully

maintained as a quid pro quo for participation in the refinancing arrangement.

-- it would allow the steel companies to engage in a more comprehensive restructuring program. It should be noted that the bill is neutral as an inducement to additional elimination of capacity and jobs. It is the past exit costs which are causing the financial crisis. Future shutdowns will be dictated by market conditions and not artificially induced as a result of this legislation, although the collective bargaining partners could submit to the Authority shutdown costs incurred after the effective date of the bill. It is the hope of the union that a comprehensive steel policy will void the necessity for any more collapsing of capacity;

-- it equalizes the adverse competitive position caused by some companies which use Chapter 11 proceedings to abandon their pension obligations. While not all companies have the same degree of exit-cost burdens, there is, nevertheless, an equitable proportional treatment in the handling of those costs by the bill.

The Union also wishes to emphasize that the general ERISA reform measures relating to an increase in PBGC premiums and more rapid pension funding rules will not suffice to handle the PBGC's crisis, 80% of which is generated by steel terminations. A steel-specific approach is also needed.

We are confronted with a worker adjustment need and a practical PBGC problem. S. 1811 addresses those issues.

II. Heinz-Metzenbaum Approach

A Worker and a PBGC Problem

The legislation before this Committee responds to a social need and meets a practical problem. The practical problem has arisen because the PBGC is not in the situation to accept many more terminations of steel pension plans. Nor can those steel companies, which do not terminate their plans, remain in a cost competitive position unless they seek other drastic cost reductions--presumably slashes in employment costs. The social need obviously is the one which is caused by massive layoffs due to structural changes. No society can simply ignore the plight of thousands of workers--approximately 43,000 steelworkers and their families--who are being severed from their jobs after long years of association with the steel industry (for many of them it has been a generational connection in our steel communities) and after having reached the age of 55 years. If our collective bargaining arrangements had not provided for early retirement benefits due to plant shutdowns, there would have been either social chaos in our steel communities or the enactment of a social measure to offer the same protection.

The Administration, through the Bruce Smart Steel Task Force, attempted to determine whether there could be

additional governmental responses. Concern for the stability of the PBGC was a motivating factor. No recommendations emanated from its study. There might be an expectation that PBGC can absorb more terminations.

Even if the PBGC could absorb all of the unfunded liabilities of the steel pension plans, workers on shutdown benefits could lose substantial amounts of their pension--in many cases over 40% of their benefits! It is, therefore, no solution for these workers that pension plans be allowed to be terminated as a response to steel restructuring demands.

Nor is it adequate to suggest that the current return to limited profitability for the steel industry (if it is to be sustained) indicates that no action is required. The increased unfunded obligations caused by past shutdowns do mandate additional annual funding contributions under current ERISA requirements. Moreover, this Congress will probably also increase those minimum funding standards. Therefore, the rapid amortization of the "exit-benefits" in addition to the faster funding rules for the unfunded liabilities of the normal benefits in the pension plans may seriously erode the ability of some steel firms to carry out their restructuring plans.

Presently, the steel companies are beneficiaries of the VRAs--although the trade moderation is not as tight as we

had expected. Nevertheless, the value of the VRAs could be undermined by the increased funding costs of the "exit-benefits". We are, in effect, suggesting that there is need for a steel transition program both to ease into the more stringent ERISA funding standards being proposed and to allow to continue to benefit from the advantages of the VRAs. The steel restructuring process is still underway and the "Steel Retirement Benefits Funding Act" can be a major readjustment contribution to that reality. According to the title of S. 1811, the intent is "to provide a transitional funding method to ensure continued pension payments to steel industry retirees and to assure the viability of the private pension system."

Pension Terminations

A recent headline in The Wall Street Journal declared: "Agency in Crisis: Bankruptcy Filings in Steel Overwhelm U.S. Pension Insurer." The magazine, Pension World, printed an article: "Steel Industry Crisis Impacts Entire Private Pension System." These articles were referring to the fact that firms in the steel industry were using Chapter 11 of the federal bankruptcy code to terminate their pension plans. Little reference was made to the fact that when pension plans are terminated, some retirees--those on shutdown benefits--can lose a major part of those benefits

since the Pension Benefit Guaranty Corporation does not fully protect the promised level of the benefits. Furthermore, the active employees are deprived of the protection by the PBGC for any subsequent pension plan which might be negotiated.

Nevertheless, all three of these observations are accurate:

-- The PBGC is being critically exposed to threatened steel pension plan termination,

-- The private pension plan system is being strained to serve as a social readjustment system during severe restructuring periods,

-- Workers in the steel industry are losing substantial pension benefits despite PBGC protection.

Early Shutdown Benefits

The USWA readily acknowledges that the PBGC is under great pressure. Approximately 80% of its $4 billion deficit is due to termination of steel pension plans. But what we are witnessing is a test as to whether our private pension plan system, augmented by the protections of the PBGC, can provide the needed social measures; namely, early pension benefits to senior employees, during deep restructuring periods.

On July 31, 1987, the Commission of the European Communities announced a proposal to eliminate 33 million tons of finished steel capacity, resulting in the loss of 80,000

steel jobs over a three-year period. But most significantly, and certainly most typical of our European trading partners, the Commission noted:

> "By the expansion of national provisions for social back-up measures, aid to early retirement will continue to be a major aspect of action taken by all steel-producing Member States, because it has proved to be the only 'realistic' measure enabling a massive and rapid reduction in the workforce. . . . Such reductions in employment in the steel industry (and in sectors dependent on it) will have enormous regional consequences. . . . For this reason, the further restructuring of the steel industry requires that social and regional flanking measures be adopted as a matter of urgency."

I hasten to note that these European measures are all publicly financed. Programs for American steelworkers, subjected to the same restructuring forces, are, however, privately financed as a consequence of collectively bargained arrangements, negotiated many years ago. Nevertheless, there does remain a role for a public policy involvement in what still can remain a privately financed obligation. That role is dictated by the twofold fact that the PBGC cannot be a restructuring agency for the steel industry (nor for any other industry experiencing similar structural pressures) and the private pension system is not designed to sustain in the short term the social costs of massive closures. Since 1981, the domestic steel industry reduced its capacity by 27% and its workforce by over 50%.

I need not reiterate the failure of other policies which have contributed to the steel crisis. USWA has testified to those issues before the trade committees. However, the fact of the matter is that these shutdowns have occurred and further capacity retrenchment is being advocated. A strong word of caution is warranted with regard to further shutdowns. Fred Bergsten, writing for Foreign Affairs, noted:

> "America must aim for export-led growth for the rest of this decade and into the early 1990's. . . . Virtually all of the trade improvement must come in the manufacturing sector. . . . Such a shift would require an expansion of about 30% in capacity of the U.S. manufacturing industry over the next five years."

Heinz-Metzenbaum Approach

The legislation, "Steel Retirement Benefits Funding Act" (S.1811) introduced by Senators Heinz and Metzenbaum, was developed to address the short-term burden confronting the steel industry with regard to certain cost obligations of its pension liabilities. The main objective is to deter further terminations of steel pension plans, thereby removing the exposure of the PBGC. When pension plans are terminated, the total unfunded liability of the plan is transferred to the PBGC. That obligation is then financed by premiums collected from other companies.

The proposed legislation would "offload" from a steel firm's pension plan and transfer to a newly established

Authority only those future obligations in excess of the normal pension payments. These are those payments which are related to the early benefits to be paid to those workers who lost their jobs prior to normal age of retirement and which job losses are due to plant shutdowns between 1982 and 1987. The Authority, through the sale of bonds guaranteed by the government, would provide a 10-year financing mechanism to cover the cost of these pensions. But the participating steel firms would have to surrender to the Authority assets, the value of which would offset the pension obligations transferred to the Authority.

Of particular note is that the obligation to be assumed by the Authority covers both the pension benefit and the supplement. This latter measure is an essential component of an early shutdown pension system because it compensates for the lack of the social security benefit which the worker is not authorized to receive until age 62. Pensions in the steel industry must be supplemented by social security payments. Otherwise they would be grossly inadequate. Hence, we have negotiated a $400 per month supplement for those workers on shutdown pensions who have not reached the age of social security eligibility. It is this measure which is totally lost when PBGC takes over a terminated pension plan.

Future Restructuring

You will also note that any additional shutdown obligations incurred by steel firms after the date of enactment may be assumed by the Authority if, among other factors, the transfer of the obligations is authorized by a cllective bargaining agreement. This provision allays any concern which we might have that the Act would induce undue closure of facilities. USWA recognizes that further shutdowns might occur and are not impeded by the bill. But the additional exit-benefits associated with such shutdowns will not constitute a barrier to future efficient rationalization decision.

By handling the previous shutdown costs, the post-enactment exit-benefits need not become an unmanageable burden, thereby inducing companies to again contemplate use of Chapter 11 to terminate pension plans.

Rapid Funding

One final comment. USWA supports more rapid funding of the pension obligations. To the extent that pension plans are more fully funded, then the PBGC will not be overly exposed if there are plan terminations. We view the Heinz-Metzenbaum proposal to be an appropriate steel transition measure. More rapid funding will not resolve in the short-term PBGC's exposure, but it will accelerate pressure on steel industry resources to cover these special shutdown

benefits. By "offloading" these obligations more stringent funding obligations can be imposed to address the unfunded liabilities of the normal pension benefits.

Unless the pressure of steel pension plan terminations is removed, the ERISA reforms being proposed will not adequately address PBGC's problems. Moreover, the Congress might be precipitated into taking unreasonable actions to strike some of the 1974 guarantees now presently available to retirees. We are concerned that a proposal in the Senate Finance bill cutting back on the guarantee for shutdown benefits might succeed and, indeed, be a precedent for additional retrenchment in the scope of PBGC protection.

S. 1811 is a more reasonable approach and it avoids the above dilemma. The bill would:

- withdraw pressure to terminate pension plans,
- assure continuation of defined benefit plans for active workers,
- prevent reduction of benefits for retirees,
- relax financial pressure on the PBGC, and
- allow the steel industry to restructure.

Senator METZENBAUM. Our next witness is Mr. Curtis Barnette, Senior Vice President, General Counsel and Secretary of Bethlehem Steel.

Mr. BARNETTE. Good morning, Mr. Chairman.

I wish to thank and commend you and Senator Heinz, Senator Mikulski, Senator Specter and so many others who have led this very creative legislative search for solutions to the very critical problems of our company and of our industry.

We have had the privilege of working with the Administration during this past year, and with the Congress, and we were pleased to learn this morning the position of the Administration on these important issues, and we look forward to continuing to work with the Administration and with the Congress.

I would submit most respectfully that over this last year, 10 principles and conclusions have emerged, and they set the foundation upon which S. 1811 should be considered. And if I might just briefly state them: First, it is in the national interest to have an internationally competitive basic domestic steel industry; second, the massive over-capacity worldwide of the international steel industry has required major structuring of the total worldwide steel industry and further restructuring is going to be required; third, foreign steel companies, largely Government owned and controlled, are pouring literally billions of dollars into the restructuring efforts in their respective countries through loans, subsidies, and other grants.

Fourth, the Federal Government has a pension liability of billions of dollars, 80 percent of which is due to steel company bankruptcies and plan terminations.

Fifth, Chapter 11 is not the appropriate way to reorganize the domestic steel industry, and we should not miss the facts. Twenty-five companies are in these proceedings and over 20 percent of our industry.

Sixth, a major source of financial distress has simply been these extraordinary financial problems posed by restructuring and more particularly, shutdown-type pensions.

Seventh, an appropriate Federal response to Federal pension liabilities and these restructuring liabilities is required through a steel-specific solution.

Eighth, the Administration and the Congress have a number of pension reform proposals, and I have submitted, Mr. Chairman, as an exhibit to my statement, an outline of five specific pension transition legislation proposals. If I understood the Administration correctly, at least as to items 1, 2, and 4, there seems to be a consensus that the Administration agrees with those steel transition legislation proposals. Item 3 is S. 1811, and 5 deals with premiums. We look forward to developing these further in the legislative process.

Ninth, pension transition legislation is absolutely necessary to permit the industry to remain and to become more competitive and to be restructured.

And I guess finally, the ninth and tenth areas of concern, and I will inter-relate them, and here, there is debate; and I suppose that is why we are here, Mr. Chairman—S. 1811, we believe, addresses all these issues in a most creative and innovative way. It was interesting to hear the last panel, because it seems to me that the crite-

ria that they set for dealing with such issues has indeed been met by S. 1811. Bethlehem supports its enactment and thanks you for your leadership in bringing it forward.

Senator METZENBAUM. Thank you very much, Mr. Barnette.

[The prepared statement of Mr. Barnette follows:]

November 20, 1987

United States Senate
Subcommittee on Labor
Committee on Labor and Human Resources

S. 1811

Steel Retirement Benefits Funding Act of 1987

Statement of Curtis H. Barnette, Esq.
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215-694-5896

Good morning. I want to first thank Chairman Metzenbaum for moving so promptly to schedule a hearing on S. 1811 and for including Bethlehem in this panel. Secondly, I want to convey the personal regrets of Walt Williams, Bethlehem's Chairman, that he is unable to testify in person today because of a long-standing requirement to be elsewhere. He has specifically asked me to advise you that S. 1811 has his enthusiastic personal support, and that he considers its enactment a top priority of Bethlehem Steel Corporation.

During the past year we have worked closely with the Administration, particularly the Economic Policy Task Force, chaired by Undersecretary Bruce Smart of the Commerce Department, and with the Congress, on industry restructuring and pension issues. It is respectfully submitted that ten very basic principles and conclusions have developed, and it may be appropriate to summarize them this morning.

1. It is in the national interest to have a sound, internationally competitive domestic steel industry.

2. The massive overcapacity, worldwide, of the steel industry has required major restructuring of the total international industry, and further restructuring will be required.

3. Foreign steel companies, largely owned and controlled by foreign governments, have been restructuring and they continue to do so, with billions of dollars of foreign

government subsidies, loans, grants, and other financial support.

4. The Federal Government has a pension liability of billions of dollars, 80% of which is due to steel company bankruptcies and pension plan terminations.

5. Chapter 11 is not the appropriate way to reorganize the domestic steel industry, and responsible public policy should develop alternatives.

6. A major source of domestic steel company financial distress has been the extraordinary liabilities associated with restructuring, and more particularly shutdown type pensions.

7. An appropriate Federal response to both Federal pension liabilities, and steel industry restructuring liabilities, is a steel specific solution.

8. The Administration and the Congress are considering a number of general pension funding reforms and proposals. Some of these would be counterproductive, indeed devastating, to the domestic steel industry.

9. Steel transition pension legislation is necessary to permit the domestic industry to return to long term profitability and maintain international competitiveness.

10. S. 1811 addresses the restructuring liability issues in a creative manner and is a necessary part of the steel transition legislation.

It was my privilege to be with the Chairman, Senator Heinz, and Senator Specter on October 22nd for the announcement of the introduction of S. 1811. As I made clear on that

occasion, we believe that steel-specific transitional legislation to assist the industry in financing a portion of its enormous restructuring liability is appropriate, in the public interest and a necessary part of pension funding proposals now pending before the Congress.

Bethlehem and other steel companies have incurred many billions of dollars of retiree pension and health insurance liabilities as a result of the massive restructuring of our industry that has taken place since 1982. During this same period the industry incurred about $12 billion of financial losses. Because of these serious, adverse developments alone, it is beyond doubt that the financial problems of the nation's steel industry and the financial problems of the nation's pension guarantee system are fundamentally interrelated. It is also clear that the very modest profits reported by the industry in 1987 do not provide an adequate long term solution to these problems. If you remove the impact of the investment tax credit cashout and other accounting adjustments, the major steel companies reported only marginal profits for the first nine months of 1987.

Mr. Chairman, we believe that S. 1811 is an integral and essential part of a comprehensive United States Government response to the problems facing the domestic steel industry. It is obviously not a stand-alone solution. World overcapacity in the range of 200 million tons will clearly require continuation of the President's Steel Program beyond 1989. And such a response must recognize and encourage the many costly measures

the industry has undertaken to modernize its facilities and enhance its international competitiveness.

I recently addressed these issues in some depth in testimony prepared for presentation to a Congressional Steel Caucus field hearing in Allentown, Pennsylvania, on October 2nd. I have attached a copy of that statement and supporting exhibits as an exhibit to my statement today, and I ask that they be included in the record of this hearing. The exhibits state the facts and document the need for a steel pension solution.

Of immediate concern is the need for appropriate transitional legislation that recognizes the impact of certain proposed pension funding rules on financially distressed steel companies. We believe that S. 1811 is a key component of such legislation. There must also be an appropriate phase-in of minimum funding standards and relief from the adverse consequences of retroactive lien provisions. It would be most unfortunate if the ability of companies to honor the deserved and hard earned benefits of retirees would be jeopardized by the very reforms intended to further protect those benefits. I have attached as an exhibit to this statement a brief draft of the key provisions necessary in Steel Pension Transition legislation.

S. 1811, if included in such transitional legislation, represents an appropriate, innovative and very helpful response to the need for steel-specific transition to strengthen both the federal pension system and the steel industry. We fully support

S. 1811, and believe a compelling case has been made for its prompt enactment.

Thank you for allowing me to testify today on behalf of Bethlehem.

EXHIBIT 1
11/20/87

STEEL PENSION TRANSITION LEGISLATION

In order for the steel industry to meet the requirements of legislation designed to restore the nation's pension plans to health, the financial conditions of the steel industry require a transitional approach to the pension funding standards proposed for the Budget Reconciliation bill. In the absence of such an approach, pension funding legislation may prove counterproductive both for the industry and for the PBGC. An adequate transition rule should have at least five provisions.

1. Minimum Funding

Presently underfunded plans should be permitted to correct their funding deficiency on a basis consistent with permitting the plan sponsors to achieve financial recovery and adequate funding. This should be accomplished by (i) a special rule such as the 1% improvement in funding contained in both House committee proposals, (ii) the generically reasonable transitional approach reflected in the Senate Labor Committee funding proposals or (iii) an appropriate combination thereof.

2. Timing of Contributions

Any acceleration of the timing of pension contributions should be phased in over a 5-year period so that the cash flow implications are realistically manageable.

3. Financing of Restructuring Costs

Because much of the present underfunding of steel pension plans was caused by the very high and unexpected costs of the recent massive restructuring necessitated by world overcapacity and rampant unfair trade, a federal transitional pension financing program as proposed in S.1811 should be made an integral part of any steel pension transition rule.

4. Lien Provisions

The imposition of automatic liens on companies with existing underfunding could be counterproductive and cause severe adverse financial consequences under various company financial and other agreements. If, nonetheless, such a proposal is considered, "old liabilities" as defined by the Senate Finance Committee, should be excluded from any such provision.

5. PBGC Premium

If a variable rate premium keyed to plan underfunding is adopted, its application to present underfunding should be phased in slowly to permit limited resources to be applied to funding the plan rather than payments to the PBGC. A transition rule excluding "old liabilities" as defined in the Senate Finance Committee proposal from the underfunding calculations for a period of at least five years would be appropriate.

EXHIBIT 2

October 2, 1987

Congressional Steel Caucus Hearing

Statement of Curtis H. Barnette
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Draft 10/2/87

October 2, 1987

Congressional Steel Caucus Hearing

Statement of Curtis H. Barnette

A. Introduction

Mr. Chairman and members of the Panel.

Bethlehem Steel Corporation and I appreciate very much this opportunity to appear.

We commend you for holding this Hearing, and we thank you for your leadership and assistance.

This Hearing will focus on many of the critical issues facing Bethlehem and the steel industry --

1. Conditions of the industry
2. Restructuring and its consequences
3. Retiree benefits, and
4. Possible legislative solutions to certain of the problems.

At the outset let me say as forcefully and sincerely as I can, that Bethlehem is dedicated to continue to recognize the deserved, and hard earned benefits of our retirees, and we will continue to take all appropriate steps to try to maintain these benefits now and in the future. We support appropriate federal legislation that will help maintain retiree medical, insurance and pension benefits.

Bethlehem's unfunded pension obligation is quite substantial. However, Bethlehem has always met the annual funding requirements under the law, under ERISA -- and we believe that our overall business strategy should allow us to do so under present law in the future. This year we contributed $150 million to the pension trust fund to meet the ERISA funding requirement. Next year we expect the requirement to be about $180 million.

In the near-term, we believe that these payments should probably be viewed in the context of our current liquidity of over $500 million.

Over the longer-term, to meet our pension funding obligation, we must be profitable and we must generate sufficient levels of cash flow. Our past actions have returned us to marginal profitability and our strategic plan is aimed at keeping us profitable. We continue to believe there is an appropriate and necessary role for the Federal Government in dealing with the pension related issues as the domestic steel industry moves through this difficult period of transition.

The seriousness of Bethlehem's commitment to these issues is indicated by the presence of four Bethlehem Vice Presidents who have responsibilities in the areas of concern at the Hearing, and who are with me today:

1. Ben Boylston -- Vice President, Human Resources
2. Larry Adams -- Vice President, Union Relations
3. Bill Wickert -- Vice President, Federal Government

Affairs

4. Steve Donches -- Vice President, Public Affairs

My Statement is divided into three parts:

1. General reference and background information;

2. Bethlehem's Recent Federal Government Affairs activities; and

3. Recommendations in three particular areas - pensions, trade and antitrust.

Bethlehem has recently filed with the Securities and Exchange Commission a proposed public offering of shares of common stock. As a result there may be some legal constraints upon my ability to talk about certain areas of the business and affairs of Bethlehem.

B. General Reference and Background Information

It may be helpful to comment on the following as general reference and background information:

1. The Condition of the Domestic Steel Industry
2. Actions taken by the Domestic Steel Industry
3. Information about Bethlehem Steel Corporation
4. Foreign Steel Restructuring

On February 20, 1987, a Subcommittee of the House Committee on Education and Labor held a Hearing on Steel Industry Pension and Health Benefits in Pittsburgh, and I filed a Statement dated March 5, 1987.

On March 24, 1987, there was a Joint Oversight Hearing (Senate Subcommittee on Labor and House Subcommittee on Labor Management Relations) on Overfunding and Underfunding of Pension Plans, and I filed a Statement dated April 3, 1987.

On May 6, 1987 I had the privilege of filing a Statement and testifying before the Senate Judiciary Committee, and many of the comments I made at that time (and the associated Exhibits 1-18 hereafter) are equally appropriate for this Hearing. Copies of those Statements and Exhibits are available from my office.

1. The Domestic Steel Industry

The domestic integrated steel industry has experienced serious problems. The major producers have incurred over $13 billion of losses since 1982. (Exhibit 1) More than twenty percent of industry capacity is now in Chapter 11 Bankruptcy

reorganization. (Exhibit 2) While on the surface the financial results for this year may seem to provide some relief from the oceans of red ink that have engulfed us since 1982, the industry continues to have financial difficulties. (Exhibit 3)

At the heart of the problem is a world overcapacity in steel producing facilities on the order of 200 million raw steel tons. (Exhibit 4) With this world overhang, our government certainly should be doing nothing to cause further expansion of steel production facilities in other countries. In the United States, there is still overcapacity in both steel production and finishing facilities and in iron ore pellet production facilities. Despite costly shutdowns of 42 million tons of capacity since 1981, industry operating rates were not satisfactory. (Exhibit 5)

Imports continue at very high levels and, despite the President's Steel Program, have exceeded the "expected results" of the Program by 20 percent. (Exhibit 6) In addition, indirect steel imports have doubled over the last ten years, a fact which refutes claims of declining steel intensity in the American economy. (Exhibit 7)

2. Actions taken by the Domestic Steel Industry

The domestic industry has addressed its problems aggressively and realistically in recent years. I have already noted the 27.5 percent reduction in capacity since 1981. We have reduced our work force by more than 55 percent from 391,000 in 1981 to 174,000 in 1986. (Exhibit 8) Labor contracts in

1983 and 1986 resulted in significant wage and benefit cuts and staffing reductions, and salaried workers have also had significant reductions in wages, benefits and force levels. (Exhibit 9)

The industry has spent $7 billion, or 170 percent more than its cash flow between 1982 and 1985, to maintain and modernize its facilities. (Exhibit 10) The percent of steel which is continuously cast has more than doubled since 1981 and is now over 50 percent and rising fast. (Exhibit 11)

As a result of all these measures, the industry's productivity has increased more than 30 percent in manhours per ton since 1982. (Exhibit 12) Labor productivity for carbon steel in the United States is now the best in the world at 6.3 manhours per net ton. (Exhibit 13)

Industry Problems Remain

The comprehensive self-help programs I have highlighted and the import relief provided by the arrangements negotiated with countries under the President's Steel Program have not been enough to restore the industry for the long term.

The massive restructuring effort has established an enormous responsibility for ongoing pension, health and other retiree benefit costs. (Exhibit 14) This liability has to be carried by an industry whose production, active work force, sales and cash flow are continually shrinking. The industry's ratio of active workers to retirees has gone from 2.3 in 1977 to .5 in 1986. (Exhibit 15) A great many of the employees

retiring in the last five years are receiving unreduced early retirement and shutdown benefits, which dramatically affect pension funding.

The significantly increased restructuring costs are in addition to the more than $8 billion of debt incurred by the industry to modernize its facilities, and this must be serviced by a sharply reduced base of sales and cash flow.

The industry has accomplished major cost reductions per ton since 1982 (in Bethlehem's case more than $130 per ton) -- only to see these extraordinary efforts neutralized by reductions in selling values of 10% or about $50 per ton. (Exhibit 16) Import prices remain 20 percent below 1982 levels despite the President's Steel Program and the declining dollar. (Exhibits 17 and 18)

3. Information about Bethlehem Steel Corporation

Bethlehem Steel Corporation is the third largest integrated steel producer in the U.S. From 1982 through 1986, Bethlehem sustained five consecutive years of financial loss. Total loss for this period was over $2 billion, including some significant restructuring charges. The company has been downsizing drastically, with total employment declining 55% from 83,800 in 1981 to 37,500 last year, and continued restructuring is required. Despite these losses, and our major restructuring, Bethlehem has invested over $2 billion to modernize and maintain its facilities over the last five years, which is far more than its cash flow from operations.

Bethlehem anticipates that it will report both operating and net income for the third quarter of 1987. Bethlehem currently estimates that domestic industry shipments will be about 70 million tons during both 1987 and 1988. Bethlehem's backlog of orders remains strong, particularly for sheets and plates, and in August, 1987, it restarted the 110-inch plate mill at its Burns Harbor plant. Bethlehem expects its steel shipments and average prices for flat rolled products for the third quarter of 1987 to improve moderately over second quarter levels.

Despite the currently improved operating environment, Bethlehem and the rest of the domestic steel industry still face a number of fundamental long-term problems which must be addressed. They include the need for further restructuring and modernization of the domestic steel industry. In addition, the high economic and social costs of capacity reductions, both past and prospective, are of great concern to the industry, which has a drastically reduced active work force which must support health insurance and pension costs of a retiree group more than double its size. Additional problems include excess steel capacity worldwide and imports in excess of the levels prescribed by the President's Steel Program. Bethlehem is working closely with the United States Government and others to find ways to resolve these issues. Bethlehem continues to pursue additional cost reductions, quality improvements and enhanced customer service and to rebuild its financial strength.

C. Bethlehem's Federal Government Activities

We are very proud of the efforts we have made in Washington, D.C. over the past year on the pension and restructuring issues. Just as steel trade was a critical issue for which Bethlehem assumed leadership in 1983 and 1984, Bethlehem is also leading pension and industry restructuring activities today.

We believe the Administration and the Congress do recognize the serious problems of the domestic steel industry.

Last October, an interagency task force of the Economic Policy Council of the President's Cabinet, began studying a broad range of public policy options. Bethlehem worked closely with the task force and provided data and offered our best judgment and recommendations as to alternative public policy responses that might be appropriate. We met regularly with officials at the Labor, Commerce, Treasury, and other Departments, and with the Office of the Special Trade Representative. We associated with us professional advisers in financial, economic, and legal areas, and have made them and their work available. We have coordinated with the United Steelworkers of America, other steel companies, the American Iron and Steel Institute, and others. We are, of course, very hopeful that the Congress and the Administration will develop a meaningful program to recognize the past restructuring, the major self help steps that have been taken, and the further restructuring that is necessary. We believe that such a program

Specifics on the number of employees that will lose steel industry jobs are still difficult to establish. However, it is certain that government funding will be involved to assist in the transfer of employees to new job sites, retrain them for jobs in other industries, and partially make up the pay scale differentials for these workers.

My purpose in referring to the social programs in these countries (and there are many others) which assist in steel industry restructuring is not to offer these programs as models for the U.S. However, these steel producers are our competitors in our marketplace. Their governments recognize a legitimate role in assisting their steel industries and their workers. We believe the U.S. government can and should do the same.

D. Recommendations

While there are a number of legislative and policy recommendations that are both necessary and appropriate, we believe that three warrant special attention.

1. Pension benefits must be maintained and prompt federal legislation is appropriate to establish a steel pension transition plan.
2. The President's Steel Program must be continued after 1989, and our trade laws must be strengthened and enforced.
3. Antitrust law and policy must be reasonably applied.

1. Pension benefits must be maintained and prompt federal legislation is appropriate to establish a steel pension transition plan.

There is now pending before the Congress the Administration's pension funding proposals, as well as additional legislative alternatives developed by the Congress.

We believe, and strongly recommend, that a specific federal steel pension transition plan be made a part of the general pension funding legislation.

There are enormous consequences of restructuring to Bethlehem and the basic steel industry. Since the President's Steel Program started in 1984, let's go back 10 years to 1974.

1. In 1974, there were over 500,000 employees in the steel industry. Today there are 170,000, a reduction of 67%. (Exhibit A)

2. In 1974, Bethlehem had 120,000 employees and today there are 35,000, a reduction of 71%. (Exhibit B)

3. In 1974, Bethlehem had 35,000 retirees and today there are 69,000, almost doubling the retiree population. (Exhibit C)

4. As a result, today Bethlehem has two retirees for each active employee. That same ratio prevails for the steel industry as a whole. (Exhibit D)

5. In 1954, Bethlehem's total annual pension payments to retirees were about $5 million. Today they are about $500 million (Exhibit E). In 1974, they were $100 million - that's an increase of 400% just since 1974. (Exhibit F)

6. Under Bethlehem's Social Insurance Program, Bethlehem provides health care and life insurance benefits for retirees. The expenses for these benefits are about $70 million per year. (Exhibit G)

7. In recent years, at least 25 steel companies have filed bankruptcy proceedings and this constitutes about 20% of the domestic industry. They have transferred over $3 billion in pension obligations to the PBGC. (Exhibit H)

8. Under current law, by transferring these pension liabilities to the PBGC, one principal industry analyst has indicated there may be savings amounting to $3 per hour in employment costs. (Exhibit I)

9. From an industry standpoint, the same security analyst has reported that at year end 1986, the present value of

unfunded pension and group insurance liabilities for the 6 major steel companies was about $12 billion on a PBGC termination basis. This liability is estimated to be close to $15 billion by 1991. (Exhibit J)

10. Steel industries in many foreign countries, who export into our market, are government owned or controlled, and they are engaged in extensive governmentally supported restructuring.

Please examine Exhibit K.

The EC reduced employment from 583,000 to 483,000 between 1980 and 1985, or 17%. During the same time, the U.S. reduced employment from 399,000 to 208,000, or 48%. The EC supported the restructuring of their steel industry by more than $43 billion in subsidies during that period.

Today the EC is planning to reduce more than 80,000 more jobs, and billions more of support will be forthcoming.

A. The Problem

1) Both America's pension guarantee system and America's steel industry are in financial trouble.

2) The two problems are fundamentally interrelated;

a) Steel's problems have been the major cause (roughly 80%) of the PBGC - or federal pension funding problem.

b) The companies' pension funding problem has been a major obstacle to required restructuring in the steel industry to make it internationally competitive;

3) Steel companies are caught in a "catch-22":

   a) Appropriate capital is difficult to obtain because of their financial condition as a result of past restructuring and the threat of overcapacity (both domestic and world- wide).

   b) Restructuring to the extent still necessary will be very difficult because capital is inadequate to deal with unfunded pension and other liabilities.

   c) Steel company employment has drastically declined.

   d) The number of retirees, and the number of retirees for each active employee have greatly increased.

   e) Companies have unplanned employment charges of from $75,000 to $100,000 for each employee who is retired early from service as a result of shutdown type pensions.

4) In this context, bankruptcy has become a strategic option.

5) But bankruptcies threaten to:

   a) Deny workers their hard earned pension benefits;

   b) Transfer 3 billion (or more) in liabilities to the PBGC (in addition to the 3 billion already transferred by steel companies to the PBGC);

c) Impede any necessary further steel sector rationalization.

6) Steel industries in many foreign countries who export into our market are government owned or controlled and are engaged in extensive governmentally supported restructuring. (Exhibit K)

B. A Non-Solution

1) Attempting to solve the general pension funding problem (as in pending legislation)--without adequately providing for steel sector transition--is a totally counterproductive non-solution.

2) It would make steel's troubles worse.

3) That, in turn, would either deepen the PBGC's funding problems or force prohibitively expensive insurance premiums on the rest of American business and labor.

C. What is needed?

1) As the general pension funding problem is addressed, what is needed also is a transitional program for steel.

2) Such a program must:

a) protect workers' benefits on a basis more favorable than bankruptcy;

b) allow the steel industry to restructure;

c) involve a fair pay-back system by the industry, and possible funds from other sources;

d) cost the government less than it would otherwise be obligated to pay; and

e) be a part of the overall pension funding legislation.

D. One Possible Solution - A Steel Pension Transition Bill

While there are undoubtedly different alternatives that might be appropriate, a steel pension transition bill (or other legislation that would accomplish similar objectives) should be considered as a part of any overall pension funding legislation.

1. The purpose would be: "to provide a transitional funding method to ensure continued pension payments to steel industry retirees while assuring the viability of the private pension system." To this end, the bill (amendment) would provide that:

   A Federal Steel Pension Benefits Authority ("Authority") and a Steel Pension Benefits Investment Fund ("Fund") would be established.

2. The Authority would:

   a. enter into agreements with Qualified Steel Corporations to make payments for certain Qualified Pension Benefits in return for stock warrants, equity, debt, or other assets;

   b. issue obligations to the Fund (convertible into steel company equity) in return for payments from the Fund; and could

   c. receive funds from other sources.

3. The Fund would:

   a. issue shares to the general public;

   b. transfer payments to the Authority; and

c. hold Authority obligations and associated company assets--and manage these for the benefit of shareholders.

4. Qualified Pension Benefits would be:

a. the incremental pension annuities payable to a defined and limited number of Qualified Retirees as a result of their early separation from service.

b. monthly supplemental benefits payable to those Qualified Retirees who have been separated early from service;

5. Qualified Retirees would be individuals:

a. separated from service after January 1, 1981; and

b. eligible for annuities under qualified plans (which are generally the same throughout the domestic industry) upon separating from service after:

1) attaining age 55 and completing 15 years of service; or

2) completing 15 years of service and having a combined age and years of service of 80 or more; or

3) completing 20 years of service and having a combined age and years of service of 65 or more.

We stand ready to continue our cooperation with the Congress and the Administration in a prompt and all out effort to have appropriate legislation enacted.

2. The President's Steel Program Must Be Continued after 1989, and our trade laws must be strengthened and enforced.

The President's Steel Program resulted after extensive and successful litigation before the International Trade Commission. It was endorsed by the Congress in the Steel Import Stabilization Act, and represents an essential policy on trade. It recognizes and attempts to redress the sustained and pervasive pattern of dumping and massive subsidization which has been an undisputed fact of life in steel trade for at least three decades.

The current steel Program expires on September 30, 1989. It must be extended and strengthened to deal effectively with significant uncovered steel exports and increasingly resourceful circumvention schemes and until the rest of the world establishes a level playing field.

But the steel trade problem is a natural manifestation of the more fundamental problem of excess capacity. The steel industry is a cyclical, capital intensive, volume sensitive business. It is unrealistic to project long term viability without further restructuring to achieve a more realistic supply demand balance and this must be an additional policy objective that is accomplished in an orderly, fair and humane way for all concerned.

3. Antitrust Law and Policy Must be Reasonably Applied

It is clear that further restructuring of the domestic integrated steel industry must and will occur. It is therefore

most appropriate to consider whether current antitrust law and policies constrain this in a manner which is inconsistent with the public interest. Antitrust policy permitted the LTV merger, the joint venturing of new finishing capacity such as the recent electrogalvanizing joint ventures, the USX-Posco joint venture in California, the recently announced cold-finishing mill to be joint ventured by Inland Steel Industries and Japan's Nippon Steel Corporation, and the USX-Armco National-Oilwell transaction. Antitrust policy has also permitted joint research activity.

It is essential, however, that merger policies recognize the vast changes that are under way in the international as well as the American economy, and that appropriate basic policies be enacted into legislation. We must recognize the foreign government ownership and control of much of the international steel industry, and the mergers permitted by other countries of their major steel companies. That's what the American steel industry must compete against in the American market, and we should always remember that we are the only major country that is a net importer of steel. The merger guidelines as modified in 1984 recognized the need to include imports in merger analysis but the impact of imports may be too limited as a significant factor in the analysis of the domestic steel market. The evolving merger policies of the Administration seem to try to strike a proper balance between protecting the various objectives of the antitrust laws and recognizing the realities

of today's international economy. Former Secretary Baldrige and his associates at the Commerce Department also deserve credit for broadening and intensifying the public discussion of merger policy and even further expansion may be appropriate.

In general, I support many of the objectives of the Administration's initiatives introduced last year and again this year as part of the Competitiveness package. At least in the case of basic industry, the Administration's proposal to remove the incipiency standard from merger enforcement has merit. The failing company doctrine should be expanded to provide exceptions from normal merger enforcement standards in declining but strategically essential industries. In such cases, however, it seems clearly counterproductive to require that companies be totally debilitated before an exception can be considered, and here a better legislative definition for distressed industries would be helpful.

Another area of antitrust application which has received some attention in the context of our trade policy debate involves proposals to require joint labor-industry adjustment plans as part of a section 201 escape Clause petition. As the co-petitioner in one of the largest escape clause petitions ever filed -- the 1984 Carbon Steel Investigation -- I can assure you that individual company adjustment strategies are carefully considered by the International Trade Commission and the Trade Policy Committee. For distressed industries, adjustment strategy may well be more

efficiently developed on an industry-wide basis, and a limited specific legislative exemption from the antitrust laws for this purpose would clearly facilitate such a process. For other industries, however, such a process may be impractical or impossible, and I would therefore question a mandatory industry-wide adjustment plan requirement in Section 201.

I want to make one last, and fundamental, comment on the application of antitrust law and policy to the steel industry situation. While some modest changes in current antitrust law and policy may be helpful, the problems of the domestic integrated steel industry absolutely will not be resolved by such changes standing alone.

Conclusions

I believe that it is in the national interest to have a privately owned, internationally competitive, integrated domestic steel industry, and that this will be possible only with sound government policies and legislation along with appropriate actions by the domestic industry and others. We need the vision, and action of the Congress and the Administration, and we are counting on your leadership and support.

References

This Statement was based on sources referenced in the Statement and on other sources including:

1. Statement dated March 5, 1987, by Curtis H. Barnette, Subcommittee of House Committee on Education and Labor Hearing on February 20, 1987, on Steel Industry Pension and Health Benefits.

2. Statement dated April 3, 1987, by Curtis H. Barnette, Joint Oversight Hearing on March 24, 1987 (Senate Subcommittee on Labor and House Subcommittee on Labor Management Relations) on Overfunding and Underfunding of Pension Plans.

3. Statement dated May 6, 1987, by Curtis H. Barnette before the Senate Judiciary Committee, on Competitiveness and Antitrust.

4. Various texts and publications by William T. Hogan, S.J.

5. Data Resources Steel Industry Reviews.

6. Locker Associates Steel Industry Updates.

7. "Steel Retirement Cost Time Bomb", dated June 1987, by Peter F. Marcus, Paine Webber.

8. Center for National Policy, "Pensions and the U. S. Steel Industry: Toward a Solution," dated September 1987.

9. General materials and documents of the American Iron and Steel Institute.

10. Bethlehem Steel Corporation general reference sources.

11. Preliminary Prospectus of Bethlehem Steel Corporation dated September 15, 1987, regarding proposed sale of shares of Common Stock.

October 2, 1987

Congressional Steel Caucus Hearing

Statement of Curtis H. Barnette

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Exhibits

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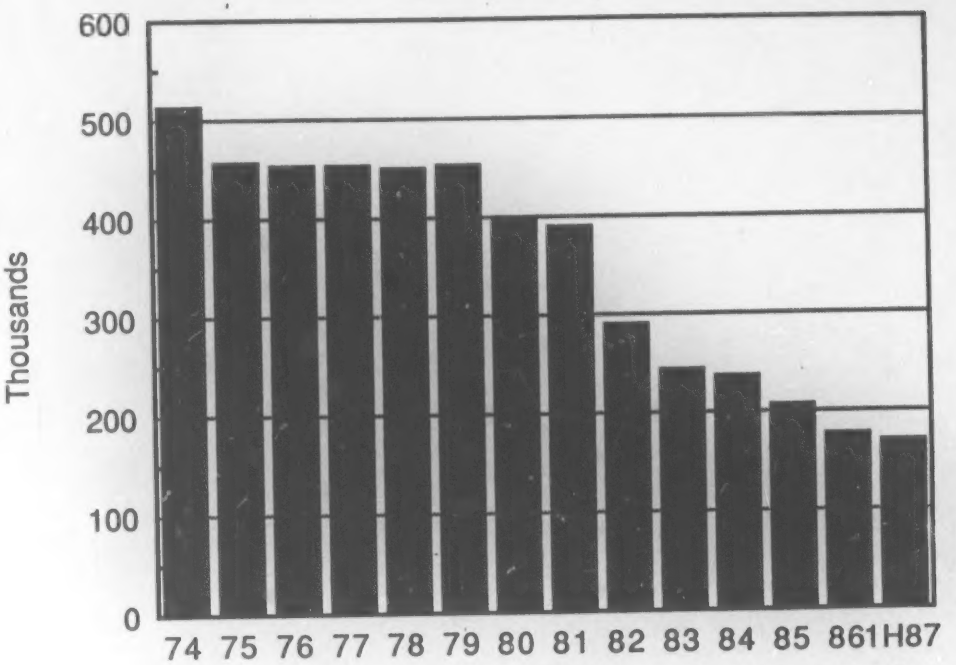
AVERAGE STEEL INDUSTRY WORK FORCE

Exhibit A

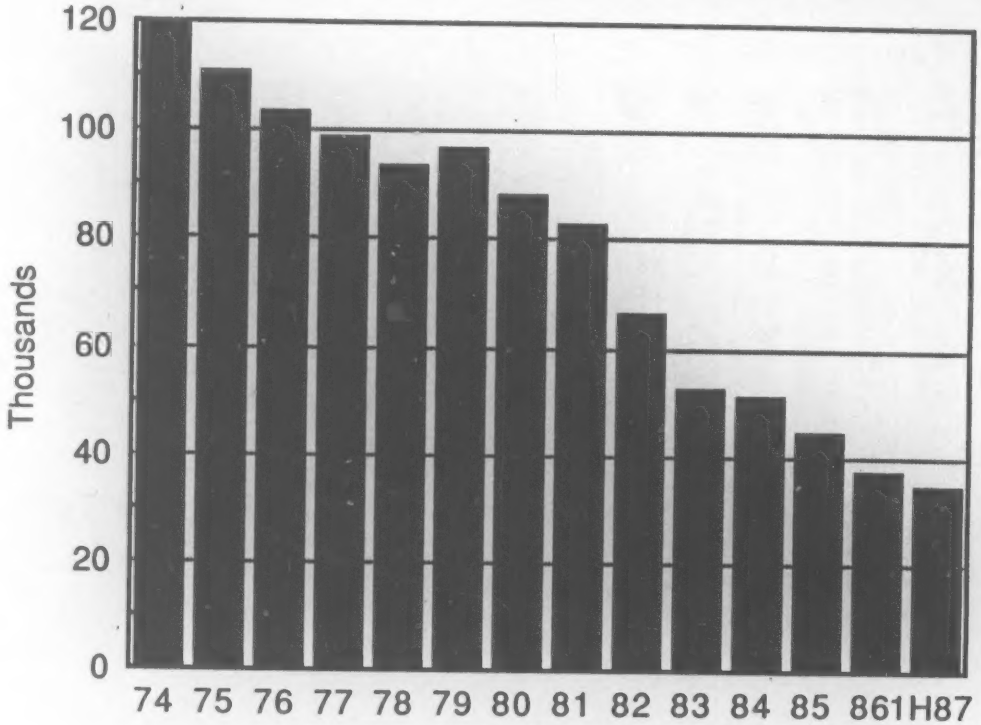


In 1974, there were over 500,000 employees in the steel industry. Today there are 170,000 , a reduction of 67%.

Source: AISI

REDUCTION IN BETHLEHEM'S WORK FORCE

Exhibit B



Bethlehem's work force has been reduced 71%, from 120,000 to 35,000, since 1974.

INCREASE IN BETHLEHEM'S RETIREES

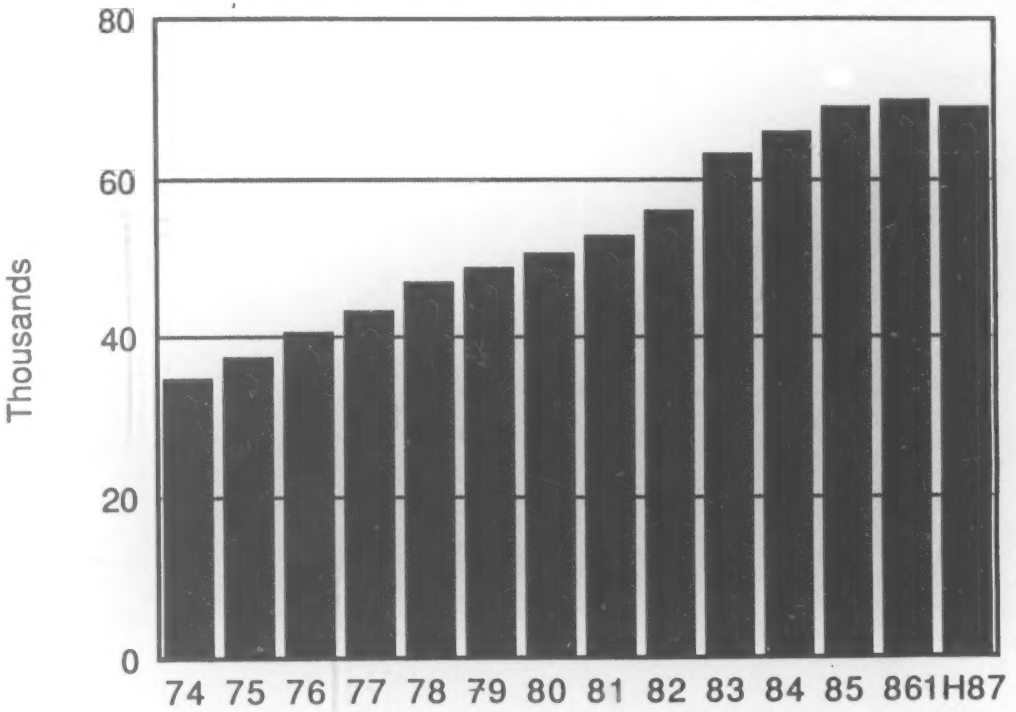


Exhibit C

The number of Bethlehem's pension beneficiaries has almost doubled since 1974, from 35,000 to 69,000.

BETHLEHEM'S WORK FORCE VS RETIREES

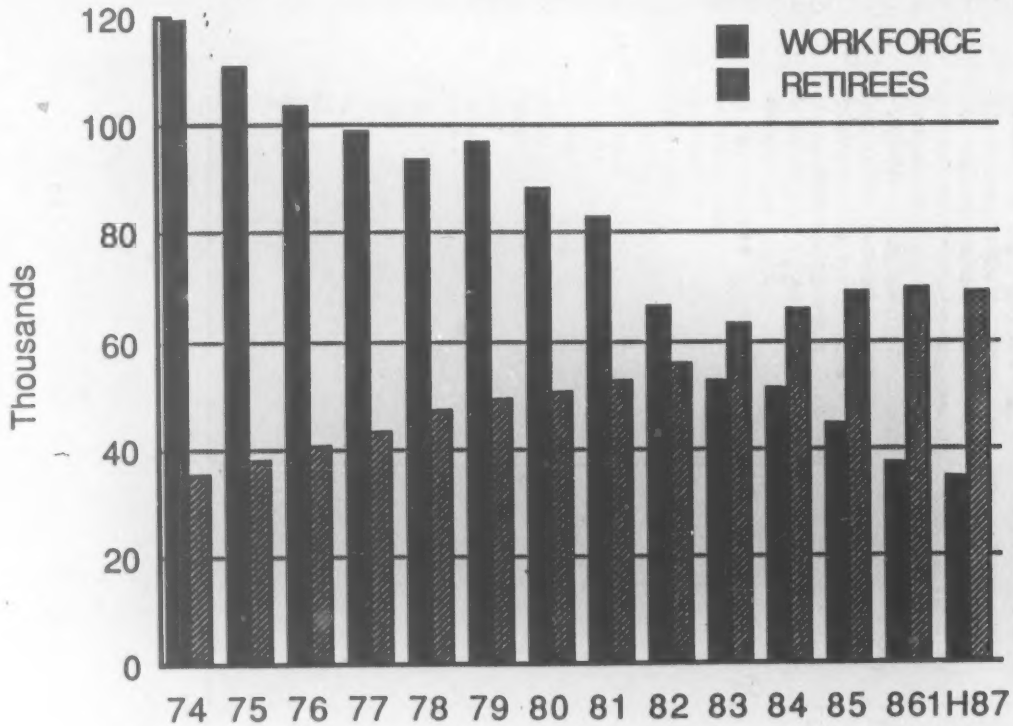
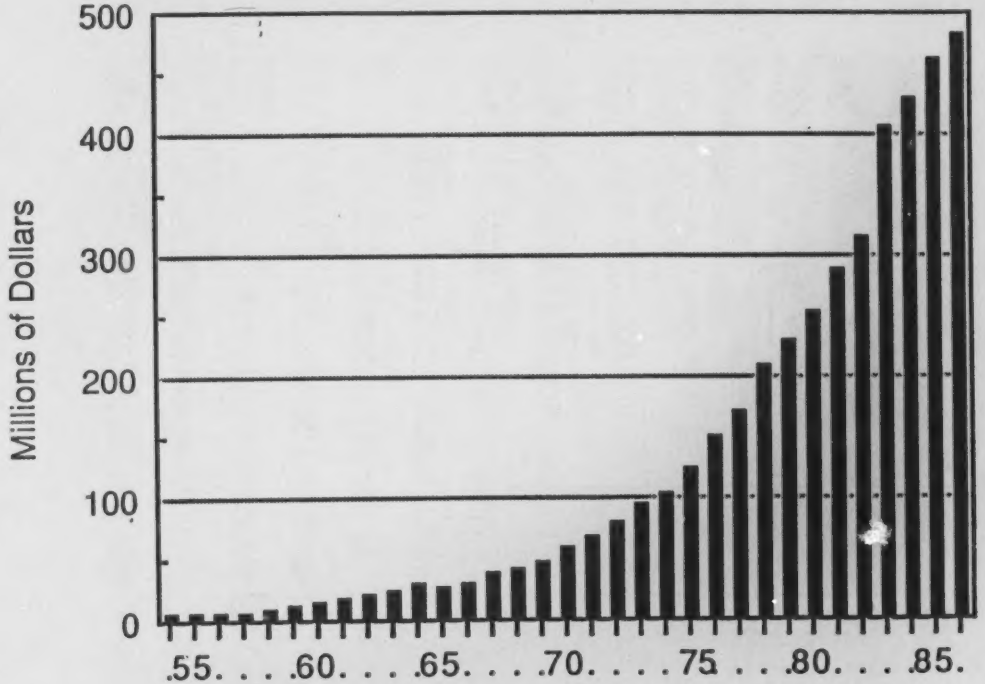


Exhibit D

Today Bethlehem has two retirees for each active employee. That same ratio prevails on average for America's integrated steel producers.

BETHLEHEM'S ANNUAL PENSION PAYMENTS

Exhibit E



Bethlehem's pension payments were about $5 million in 1954 and increased to almost $500 million last year.

BETHLEHEM'S ANNUAL PENSION PAYMENTS

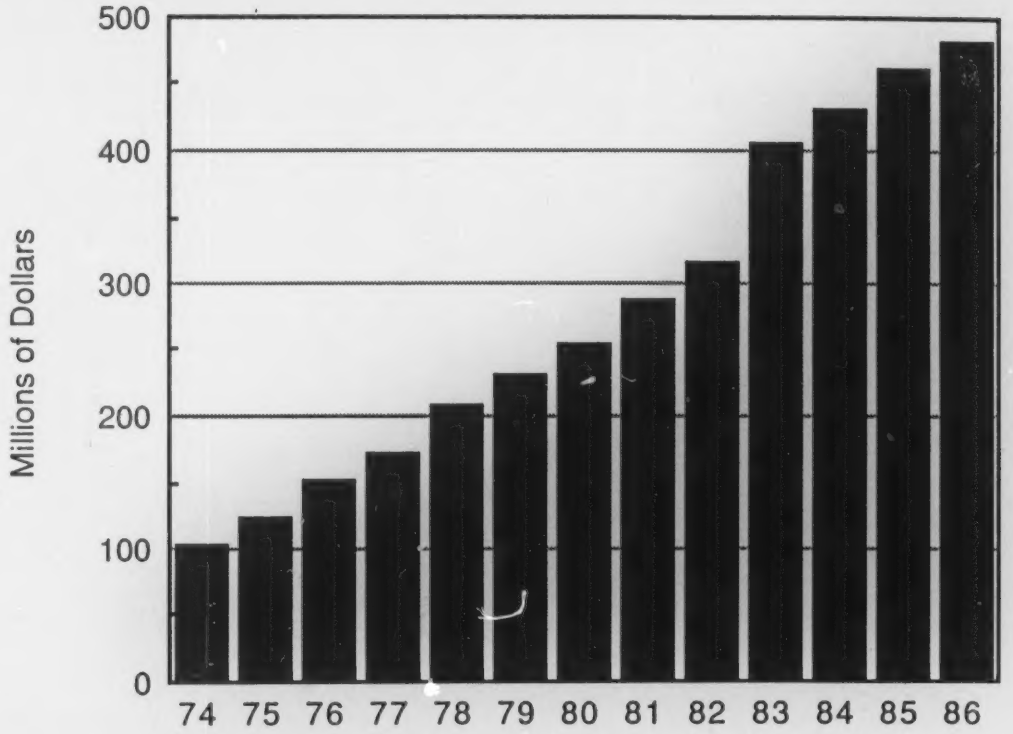


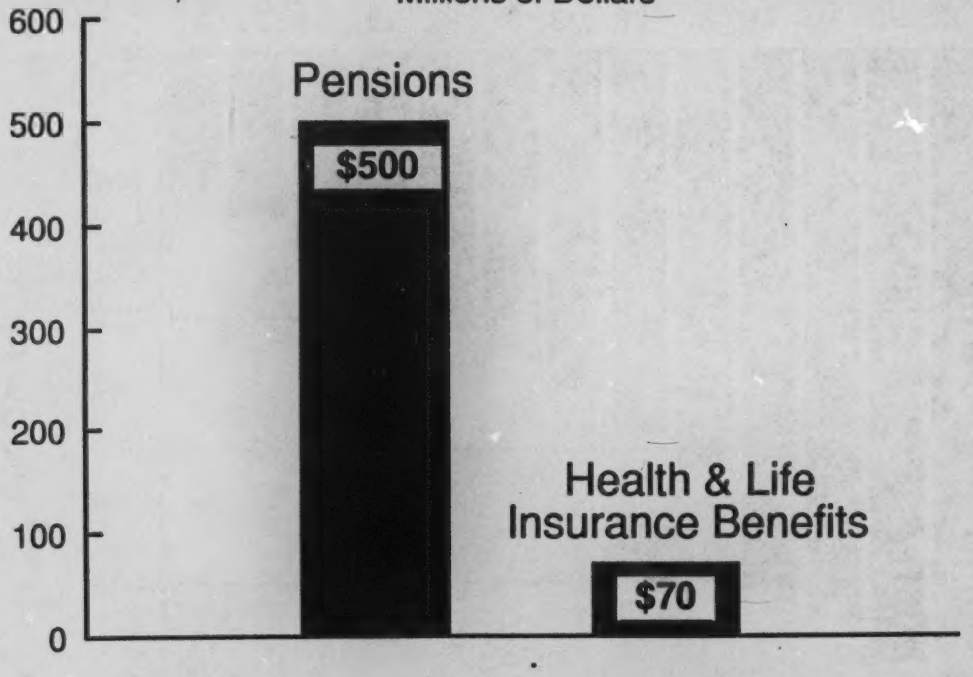
Exhibit F

Bethlehem's annual payments to its pension beneficiaries have increased 400%, from $100 million in 1974 to almost $500 million last year.

BETHLEHEM'S ANNUAL RETIREE PAYMENTS

Millions of Dollars

Exhibit G



Health care and life insurance benefits for retirees add another $70 million in annual expenses.

Exhibit H

BANKRUPT STEEL COMPANIES

Alan Wood Steel
Central Steel Tube
Continental Steel
Eastern Stainless
Fitzsimmons Steel
Guterl Specialty Steel
Hunt Steel
Kaiser Steel
Keystone Drawn Steel
Korf Steel
LTV Steel
McLouth Steel
Marion Steel
Ohio River Steel
Pacific States Steel
Penn-Dixie Steel
Phoenix Steel
Roblin Steel
Sharon Steel
Southern Electric Steel
Southwest Steel
Vasco Metals
Washburn Wire
Wheeling-Pittsburgh Steel
Wisconsin Steel

At least 25 steel Companies, comprising about 20% of current industry shipments, have filed bankruptcy proceedings and have transferred over $3 billion in pension obligations to the PBGC.

AVERAGE HOURLY EMPLOYMENT COSTS

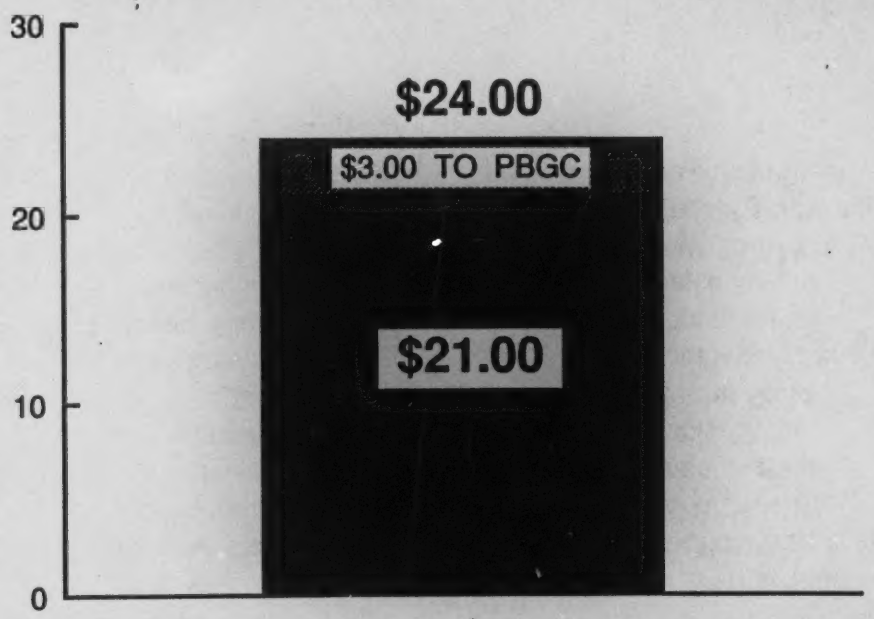


Exhibit I

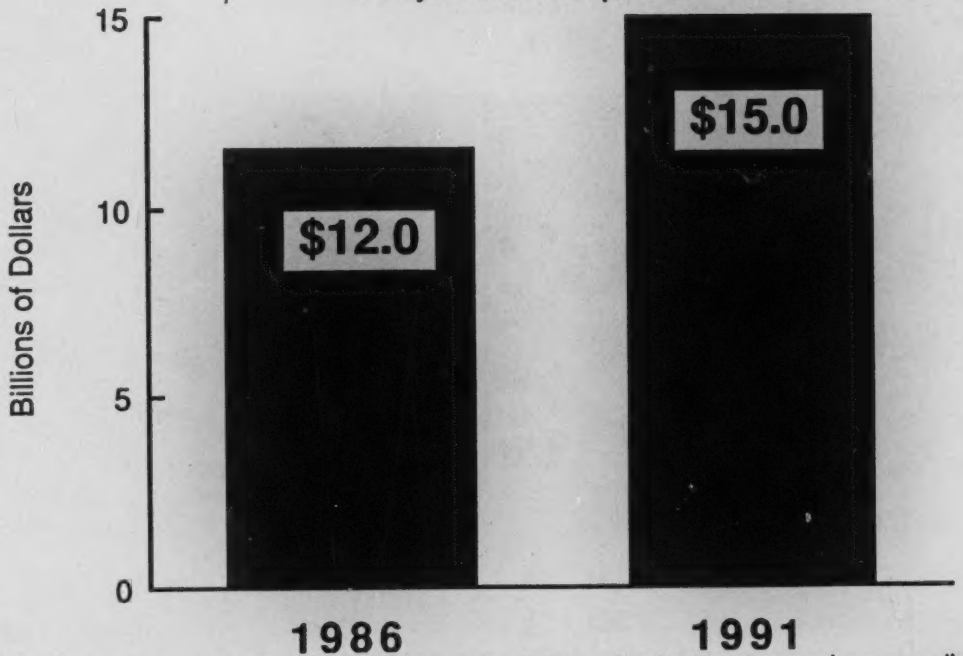
By transferring pension liabilities to the PBGC, some steel producers have saved $3.00 per hour or about 13% of total employment costs.

Source: World Steel Dynamics

RETIREE LIABILITIES

6 Major Steel Companies

Exhibit J



The present value of aggregate unfunded pension fund and group insurance liabilities, on a PBGC termination basis, was estimated to be $12.0 billion in 1986, rising to $15 billion in 1991.

Source: World Steel Dynamics

1980-1985 STEEL INDUSTRY EMPLOYMENT CHANGES AND GOVERNMENT SUPPORT EUROPEAN COMMUNITY VS UNITED STATES

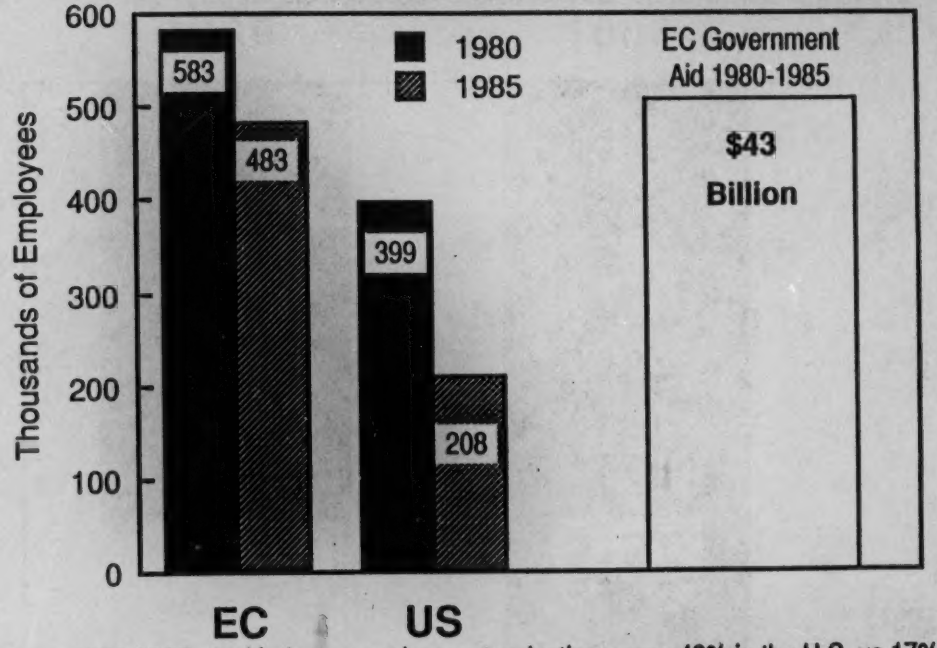


Exhibit K

1980-1985 steel industry employment reductions were 48% in the U.S. vs 17% in the EC where subsidies of $43 billion were granted to assist in restructuring.

Source: European Commission, IISI

Senator METZENBAUM. Mr. Johnston. Mr. Johnston is the Executive Vice President, Employee Relations, USX Corporation, Pittsburgh.

Mr. JOHNSTON. Good morning, ladies and gentlemen.

I, too, thank the Committee and particularly Senator Quayle, for his personal invitation to testify concerning this proposed legislation.

Despite our strong policy differences with the proponents of this bill, we know and appreciate that it was conceived in good faith by its sponsors to improve conditions for steel.

We conclude in equally good faith that in this instance, the proposed legislation will not help the industry.

USX supports the overall goal of ensuring that pension promises made to employees be kept by employers and, with proper safeguards, insured by the Government.

The provisions of this bill, however, represent the wrong approach to steel pension problem. We believe that pension funding is the responsibility of each steel company as a normal cost of doing business. On what basis should private companies and private shareholders look to taxpayers to assume the normal risks of business, such as funding pensions?

Those steel companies which have adequately funded their pensions have given up the use of all that invested money—in our case, billions of dollars—to support pension commitments. This bill would now permit the Federal Government to do much of that for our competitors.

Since the underfinanced companies with large unfunded liabilities will be vying for this aid, taxpayers run a high risk that their loans will never be repaid.

The steel industry's single biggest problem is overcapacity. The domestic industry needs to wash out inefficient production and eliminate redundant capacity if it is ever to regain solid financial footing on a lasting basis. This bill represents Government aid at taxpayer risk to keep that marginal capacity on line.

The bill ignores the role of some companies and the union in negotiating new pension increases for retirees as late as last year, which increased their pre-existing large unfunded liabilities. Should Congress now arrange to pay for that?

The bill does an end run around the PBGC's pension guarantee limitations. It will permit participants in underfunded pension plans to enjoy Government support beyond the forthcoming $1,900 per month PBGC limit.

It is certainly no surprise to learn that major banks are supporting this legislation. USX supports efforts to insure employee pensions under appropriate circumstances, but those circumstances do not include bailing out shareholders, banks, and other lending institutions.

If the Federal Government picks up the pension tab for underfunded steel companies, so that those companies can make good on their bank loans, the Government, it seems to us, will have shifted pension cost risk from shareholders of steel companies and their banks onto taxpayers. We do not think that is good for steel competition or taxpayers.

Congress would do far better to address the basic weaknesses in the present ERISA law than it would to put another Federal agency into the steel pension problem. We do not believe any company should be permitted to waive its annual pension funding obligations when it is underfunded any more than a company could ignore its FICA taxes. Chapter 11 bankruptcy should not entitle a company to terminate its pension plans or to cease funding them unless the PBGC is then given an immediate priority claim on assets of that company equal to their protection level.

Congress could and should simply make it a matter of law that Chapter 7 liquidation be the only basis for dumping underfunded pension obligations.

The President's Steel Import Program, which puts a ceiling on unfair steel trade, is working well. Congress should lend all-out effort to extending the President's program. This would provide effective and evenhanded support for all steel companies in the marketplace. That program requires no Federal money, no increased taxpayer risk, and maintains aggressive and intense competition. There is no shortage of competition in the steel industry. Overcapacity is its number one problem, and this bill creates no new demand for our product.

With steel markets currently strong and the dollar falling, fixing the obvious weaknesses in ERISA and extending the President's program would greatly aid domestic steel companies. Thank you for inviting our views.

Senator METZENBAUM. Thank you very much, Mr. Johnston.

[The prepared statement of Mr. Johnston follows:]

Testimony of

J. Bruce Johnston

Executive Vice President, USX Corporation

on

The Steel Retirement Benefits Act of 1987

(S.1811)

before the

Subcommittee on Labor of

the Senate Labor and Human Resources Committee

November 20, 1987

INTRODUCTION

Mr. Chairman and members of the Subcommittees, my name is J. Bruce Johnston. I am Executive Vice President, Employee Relations, for USX Corporation. In that capacity at USX, I have negotiated major labor contracts with large unions for many years. I have served as Chairman of the Steel Companies Coordinating Committee for labor bargaining in the Nation's Steel Industry for many years. I have also served, not only as Chief Company Negotiator, but at various times as Chief Industry Negotiator in collective bargaining for the Coal, Cement, Construction and Maritime industries. I am responsible for collective bargaining, employee benefits, pension administration, personnel administration, safety, industrial engineering, and labor contract administration at USX.

Thank you for your invitation to participate in the Subcommittees' deliberations on the proposed legislation. As a competitor in the beleagured domestic steel industry, USX has been forced to close many plants, to layoff, to pension or to terminate thousands of employees - both management and nonmanagement. I am well aware of the important role of pensions and retiree medical coverage for employees who lose jobs due to economic adversity. I support fully the overall objective of insuring that pension promises to employees should be kept, as should company promises to government, lenders, suppliers, and tax gatherers.

Proposed legislation must be seen from and evaluated in the context of its impact on the economy and the industry which it is purportedly designed to help.

It is beyond argument that market economies have vastly out-performed planned, and socialized economies of every kind and stripe on all continents, and across all cultures all over the world. Even those two huge empires of the Communist world, the Soviet Union and mainland China, for example, are now engaged in unprecedented efforts to restructure their planned and no-risk economies because they are floundering and delivering so poorly to most of their citizens. Perhaps the single most effective feature of a market economy is its constant self-renewal. It is a dynamic process which never ends. Market competition fosters

new competitors, constant cost cutting, new products, research, quality, delivery, risk taking, patents, and financial investment - all working constantly to improve efficiency, improve products and lower price; each seeking profit advantage in that endless competition for consumer preference.

Thus, it is one thing to insure the pensions for employees of failed enterprises, and USX, with appropriate safeguards, fully supports that objective. It is something else entirely and a totally different proposition for the government to say no enterprise should ever be allowed to fail. Business closings and bankruptcies are as much a part of a dynamic and effective economy as are new business starts, plant openings, new ventures, and new materials. Capital, people, products, and markets each need mobility for our economy to function effectively. While there is some risk in that for all the players, we nevertheless support protecting employees from unreasonable risk to their pensions thru amended PBGC support. But a no risk economy is a no growth economy. We do not support the government assuming risks for shareholders, lending institutions, banks, and executives. To the extent that this proposed legislation does exactly that, it is not good public policy. It may also, if enacted, be harmful to the very industry it purports to help. Piecemeal, patchwork aid which fails to go to the heart of industry problems tend to worsen steel problems, not help, long term.

USA integrated steel producers have been impacted by many recent events. New developments in competing materials have invaded some traditional steel strongholds. The rise of domestic mini-mills, operating with electric furnace practice and low capital entry cost, have captured other market segments formerly dominated by integrated producers. Some of us are severely challenged by inefficient domestic competitors now operating with advantages provided them via federal bankruptcy laws which, very simply, work to subsidize their financial costs - and in a capital intensive industry like steel that is an enormous advantage for our government to give competitors who are fighting us for orders in a very cost-competitive steel market. We are also competing against growing non-union domestic competition in many product lines. There are, moreover, widely varying patterns of cost relief now being delivered to other competitors by the Steelworker Union and various State Governments.

But far more significantly, like most other steel producers in the Free World, USA producers are confronted, directly or indirectly, by the phenomenon of excess capacity.

Free World annual steel capacity now exceeds Free World annual demand by 200 million metric tons in the judgment of the most conservative authorities. In 1950, there were 32 steel-producing countries worldwide. In 1987, there are 99. There didn't used to be that many integrated plants.

Since 1974 - steel capacity in Lesser Developed Countries has leaped from 33 million metric tons to 90 million tons, and by 1990 - only two years away - we forecast that steel producing capacity in Less Developed Countries will have reached 106 million metric tons - a 300% increase in 16 years.

USA steel companies, at the moment, are participating in a stronger market than we have seen for the past seven years, but no one should be misled - with all that overcapacity still in existence, both domestic and worldwide, steel will remain a beleaguered industry until that excess capacity disappears. Strong markets for steel occur less and less often and their duration is shorter and shorter. Steel market depressions are far deeper than steel peaks and their duration has become longer and longer.

Consequently, the effects of oversupply are exactly as we all learned them in Economics 101. In an oversupplied market, each company's sales volume tends to be depressed and each company's selling price drops until a market clearing price is established, and for most steel companies in recent years, foreign and domestic, the market clearing price has been below cost.

What the domestic industry desperately needs is to wash out redundant capacity, inefficient, and failed producers. Until supply and demand are returned to some reasonable balance, few

companies will realize market prices, longer term, which will cover costs and pay the wages, benefits, and pensions our employees would all like to keep.

For the past 20 years, effective and pension responsible American steel producers have taken a beating in the marketplace from steel sold in our country which was manufactured abroad with a variety of State subsidies. In addition, much steel was dumped - sold below its real cost or price in its home market. Foreign dumpers have been tough enough for private steel companies to compete against. This legislation, if added to the current ERISA - PBGC apparatus and then combined with Chapter 11 advantages, would give another boost to a whole new class of American steel companies which are no longer selling their products based on its total and real cost to produce - they are in a market-sense emerging as domestic dumpers. These failed but born-again domestic companies are now out in the marketplace competing for sales using subsidized pensions, waived financial costs (Chapter 11 excuses debt service), and, if this is enacted, they can now seek subsidies from yet another new Federal Agency. Thus, faced with overcapacity and a critical need to reduce it, this legislation is precisely the wrong remedy!

In order to support capacity reduction goals in the USA, it would be far more effective if the Administration extends The President's Steel Import Program which puts a ceiling on trade

abuses generated from steel exporting countries which also have excess capacity problems.

This would represent effective and evenhanded support for all steel companies in the domestic marketplace, but it would also maintain aggressive and intense competition on a level domestic playing field. It would not require federal money in the form of subsidized financing, or require the government to be at risk on subsequent foreclosures of very questionable loans made politically instead of economically. Under current market conditions, if The President's Steel Import Program against trade abuses is extended and the dollar continue to seek more realistic market levels against the currencies of our trading partners, America's major steel companies should do well in the near term without need for government subsidies.

Long term, the Congress far better needs to address a problem fundamental not only to steel but all capital intensive manufacturing industries in our country. American steel and American heavy industry (which includes the largest steel consumers) have the worst and the most non-competitive capital recovery times under current federal tax law among all our major trading partners all over the world.

Ironically, we had been slowly repairing this disadvantage beginning when President Kennedy brought Professor Stanley Surrey from the Harvard Law School to Washington to counsel him on tax

matters, and the government soon began to encourage investment tax credits and accelerated depreciation. While progress on this matter remained slow, it got a big boost from the 1981 Economic Recovery Tax Act which made investments in steel mills and other capital intensive facilities much more competitive.

Steel no sooner got the opportunity provided by that boost when it was destroyed by The Tax Reform Act of 1986 (TRA). The TRA made a major shift of the tax burden from individuals to corporations and that has and will continue to hobble capital intensive industries. Addressing that problem would be a far more effective means of aiding all steel companies on an even-handed basis than will more and more patchwork subsidies to competitors who failed to adequately fund their pensions.

We support efforts to insure individual employee pensions, under appropriate circumstances. Those circumstances do not include bailing out shareholders, and risk-investors including the loans of banks and other lending institutions on the financial markets. When bank loans are repaid with interest and shareholders are repaid with dividends and/or increased share prices, those gains are taken as a reward for risk, and they are surely not shared with taxpayers. When those investments fail and those loans are not repaid, those companies and those lending institutions should not be permitted to force taxpayers to share their losses. It is no surprise to us to learn that major banks are supporting this legislation. They made risk loans at market

rates to steel companies, some of which are now jeopardized. If the Federal government picks up pension tabs for these steel companies so that they can make good on their bank loans, they will have simply shifted that pension-cost risk from the shareholders of those banks and those steel companies onto the taxpayers of this country. That's a bad bargain.

The Steel Industry is a world-wide industry and a fiercely competitive one. Our industry is impacted to a substantial degree by the national economic goals and social objectives of foreign governments, trade barriers and subsidies, monetary exchange rates and almost countless other economic factors, independent of the policies of any single country or company. The President's Steel Import Program has been working and working well in its objective of aiding U. S. producers from trade abuses by many foreign steel suppliers. The adjustment of exchange rates in the last year has also been most helpful in righting the manufacturing problems caused by the high dollar which prevailed for so long.

We believe that USX Corporation currently can produce steel at real cost now competitive with any country in the world with the possible exception of South Korea and Taiwan. That is a remarkable achievement for steel given the societal differences in cost.

Many steel companies, have made meaningful correction in noncompetitive labor rates, and in more efficient utilization of labor in steel producing operations. This correction in labor costs is working to the benefit of both employees and steel companies in attaining competitive overall costs and thus in maintaining jobs. At some of our plants, for the first time in many years, we are actually hiring new people off the street. Substantial reduction has been made in redundant steel producing capacity in the United States market, but much more needs to be done in this regard. Almost all steel companies reported profit in the 3rd Quarter and are forecasting better profits in the 4th Quarter.

It is not beneficial to viable steel producers, to their employees, or to the national economy to keep some companies in production with various subsidies merely because they cannot meet all the normal pressures of competition, including paying their agreed upon labor and pension obligations. The Steel Industry can continue to be a viable part of our basic economy only if it continues to reduce excess capacity and streamline its remaining operations so that they can compete in world-wide steel markets. We believe that subsidies by government to individual companies, merely because they are imperiled in the market by fair competition would be a big step in the wrong direction for the Federal government and its taxpayers. This proposed Federal legislation of subsidized financing would provide cheaper capital to some companies than the financial market will, and would be

interference of the wrong kind in the normal competitive outcomes of steel companies, and indeed all companies in commercial competition.

The Steel Industry in the United States includes a wide variety of companies, employees, products, customers, market niches, financial support, labor rates, and economic risks assumed by the stockholders and lenders. Analysts tend to focus on the one-half dozen large, vertically integrated carbon steel producers. But a large part of production capacity today in this country is by smaller stainless and specialty producers, mini-mills and many other market-niche producers. In this complex of companies, there are very profitable producers and, as we are constantly reminded, a number of bankrupt entities. Some of these producers are well known companies with very large retiree complements, and some are relatively new producers with no retirees. Some of these producers compete in world markets with a portion of their production exported, and some produce products that are impacted substantially by imports into this country. Other producers have little exposure to imports and compete with limited product lines only in local markets. Many of these companies have no major pension problems. Some of these companies moreover do not have defined benefit pension plans nor do they have unfunded liabilities. On the briefest review one soon learns that the Steel Industry cannot be treated monolithically. Its problems and opportunities vary significantly from company to company.

Steel companies have varying degrees of pension liability and obligation. A number of steel companies, particularly the large long-established integrated producers, have long bargained defined benefit pensions with their employee unions. Steel companies were one of the earliest groups in this country to form pension plans, and today provide among the richest pensions in the world provided to industrial workers.

A major factor contributing to underfunded pensions in the steel companies has been the extremely high cost of early retirements. A significant part of this cost comes from the rich and interrelated early retirement pensions, often referred to as Rule of 70/80 and Rule of 65 pensions. The 70/80 means an employee losing his job because of plant shutdown or other displacement whose age and service total 80 (or 70 if age 55) receives an unreduced pension for life plus a $400 per month supplement paid by the company until age 62. The much younger employee with 20 years of service and combined age and service equal to 65 can also receive that benefit. This means that a single one of these early retirements can increase pension cost $100,000 above that of a normal age 62 retirement and a typical age-service range of these people would cost $50,000 or more per individual.

Many companies have not funded their pension plans commensurate with their promises to provide these benefits. When the pension funding base was established years ago, the drastic downsizing which has occurred in this industry was not

anticipated by many companies or funded against that risk. Actuarial expectation of these costs was often not included in their funding formulae. To illustrate the astonishing degree of funding required to anticipate this shutdown cost, incurred due to early pensions, one might appreciate that the USX Steel Pension Fund is currently carrying more than three steel retirees for every steel employee now working. These numbers were reversed only 10 years ago.

Pension funding is a long term process. It requires strict discipline and financial commitment to lay a sound funding base that must internally generate earnings in a pension trust long before those funds will be needed to pay pensions.

Business managements are always faced with competing needs for always limited funds. Funds are needed to modernize facilities, to develop new business opportunities, to retire debt, for required taxes and to fund pensions. If management purchases a new facility, it may improve company productivity and profitability. Company engineers may readily believe, in good faith, that the best option for the company and its employees over the long term is to buy that new facility. They can make a case that if their company doesn't purchase the expensive facility or equipment, that it might actually increase the need for pension monies because action by competitors to acquire similar new facilities would force closing of their plants. These are normal business risks.

The extremely sharp dropoff in steel sales and production in recent years drastically reduced the man hours worked and the tons of steel shipped by all companies and depleted the base for generating revenues to fund pensions. Pensions are normally funded over a 30 year term, but even if they are funded over a relatively short 20 year span (considerably less than the normal working life of an employee), such precipitous drops in the production out-put of a company make it much more difficult to fund rapidly enough to meet demands on pension plans when so many employees are retiring over short time periods.

Pension funding shortfalls in many steel companies have been worsened in large measure by continual demands of our Labor Union for higher pensions for both future and present retirees. As part of these demands in the 70s, pensions for present and future steelworkers were substantially increased, Rule of 65 pensions were added, pension supplements were increased and a variety of other retirement costs were added.

When increases of this magnitude were given for present retirees and for the total job service of future retirees, and were combined with plant closings, enormous unfunded liabilities were created instantly for many companies. Normal funding practice would amortize these increases over the remaining life of the retiree group and the remaining service of the employee group. This means that the funding period would be approximately 15 years for the composite group. When one combines these

demands for increased pensions with the resulting increase in past service liability, a drastically shrinking work force, and an enormous increase in the number of retirees, we had a formula for a pension crunch at many steel companies.

How did USX avoid this problem? USX has a long tradition of financial discipline in funding its commitment to its pension plans. Our long-established policy was to fund heavily and on a priority basis. Consequently, we entered this large scale steel downturn with a strong pension funding base assembled over many years of prudent funding. When USX initiated its plant shutdown and workforce shrinking process in 1979, it maintained high contributions to its Pension Trusts despite a smaller work force and a smaller proceeds base, all in a determined effort to maintain that strong funding. Fortunately, financial markets moved up through the 1980s and even with the market downturn we experienced last month, USX retains a strong pension position.

Even though USX has closed more plants, has more retirees, and has a higher ratio of retirees to actives than any company in the industry, our financial discipline and determination to maintain sound funding has kept us in a strong position. <u>But recognize that we paid a heavy cost to fund those pensions!</u> That money was not available for dividends or other business opportunities and was not used to expand production when some corporations were doing that. Thus, we are strongly opposed to having competitors who failed to exercise that same discipline,

sacrifice, and business-risk judgment bailed out by legislation that uses someone else's money, including ours, to indemnify their risks.

Congress would do far better to address the basic weaknesses in the present ERISA law than it would be to put another Federal Agency into the pension problem. ERISA provided for the Pension Benefit Guaranty Corporation to protect a base level of pensions for participants in those plans that terminate because of inadequate funding. At the time ERISA was written, there was strong testimony by many pension experts that the PBGC concept was fatally flawed; i.e., the present system permits PBGC to claim a certain level of assets from a company which failed to fund adequately but the overwhelming weakness in ERISA is the fact that PBGC does not have any adequate priority in bankruptcy to obtain a failing company's assets in order to meet the PBGC pension guarantees.

Moreover, steel companies quickly discovered that the way to manage or cast off their pension promises was to declare Chapter 11 bankruptcy and simply terminate their Pension Plans. In the first place, no company should be permitted to waive its annual pension funding obligations, when it is underfunded, any more than it can ignore its FICA taxes. Pension funding should be a priority requirement ahead of other debt obligation. Congress could simply and quickly make it a matter of law that a Chapter 7 liquidation is the only basis for dumping the unfunded pension

obligations of a company onto PBGC. Companies will not then lightly use the escape mechanism of Chapter 11 to avoid their expensive pension promises.

Present law allows PBGC protection at a level of pension payment that is fairly typical for most American industry. We believe that is appropriate. PBGC should not protect pension levels that are far above the norm for American industry. No sound pension scheme indemnifies risk at the 100% level - particularly when the funds used by PBGC are provided by taxes on other companies' Pension Plans. It would be outrageous to ask other employees and companies to give the PBGC its money to pay benefits to employees in failed companies which provide pension amounts far higher than their own. But this legislation, if enacted, will accomplish that very result.

Now to the Bill itself. The writers of this legislation claim good purposes will be served by this Bill if it is enacted. They say the Bill will treat five problems. They argue that it will:

- o Avoid bankruptcies
- o Increase employee protection
- o Reduce risk to the PBGC
- o Make steel companies stand behind their promises, and
- o Not interfere in the competitive market place.

Are those goals good for the Industry and our economy and will this proposed legislation meet those goals?

Bankruptcy?

Chapter 11 bankruptcies should not entitle any company to terminate its pension plan or to permit a company to cease funding that pension plan. Chapter 11 bankruptcy is available for financial restructuring and is never used to go out of business. When a company goes Chapter 11, its pension plan should then get an immediate and priority claim on assets of that company fully equal to the PBGC level of pension protection. If a Plan is terminated and its liabilities are transferred to the PBGC, then the PBGC claim in bankruptcy should receive the same status as a tax lien. This proposed legislation fails completely to address that critical issue. This legislation ducks the issue. It does not even require that a company must utilize the financing mechanism provided in this bill. Any steel company could now have a new choice between this new subsidized financing mechanism or Chapter 11. No company should be given subsidized options to pick from the best of whatever world fits its failure most advantageously, each option using someone else's money.

Increase Employees' Pension Protection?

This Bill is based on the premise that the legislation will allow participating company pension plans to continue operating, which

means the company would be required to pay full benefits. How likely is it that a financially shaky steel company can pay for its expensive pension promises entirely and remain strong enough to repay the Government?

The Article 4 provisions of ERISA and the PBGC maintain a prescribed level of benefit protection for employees when a company plan cannot pay full benefits. For a normal age retiree, this is $1,900 per month as of 1/1/88. For earlier retirements, actuarial reductions are involved which limit payment to more typical pension plan levels. Early retirement supplements, such as the steel $400 per month additive, are not guaranteed by PBGC. In essence, the current PBGC protection level is designed to indemnify pensioners at levels typical of industrial pension plan amounts but it is not structured to protect the very high range pensions promised by steel companies. Limits on pension protection (provided, after all, by competitors' money) are essential and should be maintained. What other insurance arrangement replaces losses at full value? This legislation is designed to remove the deductible feature of the PBGC pension insurance policy, at taxpayer expense.

Congress should not ignore the heavy role of the Steelworker Union as a contributor to the failure of many steel companies. Unrelenting demands for high level pensions and liberalized eligibility are part of the pension problem in steel. Last year the United Steelworkers of America forced some of the very

companies supporting this legislation to grant retiree increases, which, in turn, directly increased their unfunded pension liabilities. Some of these companies have publicly suggested bankruptcy. Does it make good sense for unions to push financially weak companies to increase their pensions, create even larger unfunded pension liabilities and then ask taxpayers to assume the risk of paying them? Should employees be 100% protected for their increasing claims on a company while its lenders, suppliers, creditors and stockholders all suffer big losses? Should employees be made totally immune from the inability of their company to maintain its financial and economic viability?

Unions moreover have always had a right to bargain for secured pensions through involvement in the funding process. We have been advised by top Union staff that some steel companies have clauses in their pension agreement which permits the union to have this involvement. Unions also have the option to bargain for Defined Contribution Plans rather than defined benefit plans, but historically most unions have preferred to force the companies, through strike pressure, to take the risk of financial performance to support higher level defined benefit plans. With this legislation, Unions can now get both the security of defined contribution plans (via 100% protection provided by government and/or by PBGC premiums) and the richer benefits of defined benefit plans.

Reduce Risk to the PBGC?

The description of this objective in the preamble to the Bill is confused! It refers to PBGC pension cost-support as a "cost to the Federal government", but PBGC pension payments are not funded by the Federal government; they are funded by private companies with defined benefit pension plans who pay a head tax to PBGC for each covered participant. Finally, every covered company should be required to maintain current funding to its respective Pension Plans ahead of obligations to other investors or lenders unless and until they file for Chapter 7 liquidation. These changes in ERISA law would go a long way to reducing claims on the over-burdened PBGC. The PBGC should not be turned into a competitor-funded refinancing mechanism. It should be returned by Congress to its original purpose-- protecting employee pensions when there are no other assets available.

Require Companies to Stand Behind Their Pension Promises?

We have already demonstrated this legislation would soon and certainly accomplish the exact opposite.

Prevent the Federal Government and any of its Financing Methods from Distorting the Competitive Market Playing Field?

The financing scheme included in this legislation is designed, crafted, and guaranteed to do the opposite. The proposed

financing method will be far more valuable to inefficient and Pension-failed competitors than it is to USX and all other adequately funded steel companies. We are opposed to government financing support to individual companies - we are capable of paying our pensions and managing our own operations and related financial commitments without this taxpayer subsidy. So are many other steel companies.

Under the legislation, the Authority surely must value company securities offered by them to pay for the pension contributions at their true market value. Thus, if a debt instrument is used, a high credit risk company will need to issue debt of at least $1.10 to cover each $1.00 of government funds obtained. If debt instruments are used as the means of paying for government cash paid to steel pensioners, the only possible gain to a company would be the difference in the financing cost of marketing a security by that company versus marketing a security backed by the government, or marketing a government obligation. The interest saved may be close to one percent per annum for a company with a BBB credit rating. However, if the company's obligations were discounted to meet the market ratio of government obligations to company obligations, that gain would be wiped out.

The proposed legislation says under Asset Transfer Requirement

"... the company must transfer to the Authority, stock, warrants, other equity, debt, or other assets which have a value determined by the Authority to be sufficient to meet the Authority's obligations and attract investors ... ."

This appears to say that all steel company assets or obligations are to be risk adjusted. If a viable company issues to the government common shares of stock as payment, this represents dilution of present stockholder ownership. It has no greater value to that company than its own direct market issue of new shares. It carries the cost of dividends the same as any other public issue of shares. If a viable company used warrants as the means of payment to the government, then the dilution is simply delayed until the warrants are exercised. The inclusion of Warrants for interest in the intervening years would increase the dilution to present stockholders.

At the moment, the actual operation of the proposed Steel Retirement Benefits Authority is unknown. But, it would appear plainly that USX or any company with funded pensions and good credit would find no advantage to participating in this program. We have no need or desire to increase our company's debt, and in fact we are currently redeeming debt as well as boosting shareholder value by repurchasing some of our own stock. No healthy company wants to dilute its present stockholders equity. Rather it would be plainly disadvantaged by the availability of this financing to competitors who used and would continue to use their

own money to do things other than fund their pensions. As best we can determine it right now, the highest capital spending for new equipment in the industry is being made by a bankrupt competitor which is neither funding its pensions nor servicing its past debt.

Another serious shortcoming in this legislation is the fact that it is vaguely drafted and failing in specificity, particularly in its financing provisions. The politically appointed Board called for in the legislation will get to write all the critical rules and regulations for gathering and dispersing money under this legislation. That does not bode well for fiscal responsibility.

The Bill provides very broad, general, and undefined powers to a "Steel Retirement Benefits Authority". As far as we can discover, there are no ground rules for those company by company agreements called for in the Bill which are to be administered by this Authority. As written, the Authority would have power to alter the competitive position of the various companies, permitting one company a better financing deal than it might give to another company, all at its sole discretion, without the discipline of market risk. The words <u>equal value</u> appear in the text but there is no definition of how that would be determined. In fact, this Steel Retirement Benefits Authority could easily become an arbitrary Industry czar readily influencing the degree of success or failure of a given steel company. Even though the

financial amounts involved are limited, they are large - and certainly could be the swing factor in the success or failure for some companies in a highly competitive market.

In describing this legislation, one sponsor said that it would be "a mutual fund of steel companies" and that the equities being sold by the government would be backed by a package of securities from the participating steel companies. Does this mean that this new government Authority would package the strong financial securities of USX and some others with the securities of weak companies? Obviously that would work to the detriment of USX or any other viable steel company.

Is the proposal financially sound? The Bill's writers have stated

> "the federal securities would eventually be redeemed by an increase in the value of the steel assets. In 10 years the unfunded liability for shutdown benefits would be eliminated."

That assertion is, unfortunately, not supported by anything, and contradicted by everything in steel's recent experience. In fact, what they really say is that the Authority would be a speculator in the securities market.

Had this Bill been passed 10 years ago, what would the results have been? In 1979 the first large shutdowns began in steel downsizing, and our government would now be looking at a total loss of its annual payments and all the interest thereon, or it would be a substantial owner of many failed steel companies.

As every steel analyst knows, the current market value of most steel securities is well below their 1979 levels. The nationalized steel industries of Spain, Italy, France and the U.K., and so many others, all began with Government lending schemes to private steel companies, and they were never repaid. Those governments thereafter became trapped into massive subsidies, building and locating steel mills for social and political purposes instead of market-driven investments. The upshot? Mill closings came anyway because the mills too often became non-competitive, we in the USA endured subsidized imports forced upon us by these foreign political investments, massive separation benefits had to be paid, and even Francois Mitterrand the Socialist Prime Minister finally acknowledged that it had been a massive financial mistake for France. The French steel unions demonstrated against and vilified their own Socialist Government when the inevitable closings and corrections had to be made.

This proposed legislation would be a big step in that same direction.

Those who have studied subsidizing steel mills for employment purposes readily conclude that it would be far cheaper just to send checks to a given amount of workers, than it would be to build and maintain redundant facilities.

What about the Bill's potential for increasing the size of the unfunded pension liabilities. If this Bill provides a financial mechanism to pay the current unfunded pension obligations of a particular company, what prevents employees from demanding higher pensions for present and future retirees and thereby creating new past service liabilities. What commitment could possibly restrain the labor unions involved from taking the fullest advantage of this steel pension bail-out by pressing for more? This potential is made all the more likely by an amendment, that slipped in on cat's feet to Section 5 since we first looked at the Bill.

Paragraph (C) of Section 5 provides that once the Bill is enacted, in order for any steel employee to qualify as an applicant for benefits thereunder; his application must be

> "authorized pursuant to the terms of a collective bargaining agreement between such corporation and and an employee representative of such individual."

Since no existing collective bargaining agreement has (or obviously could have) such a provision, then any company wanting to participate in this government funding will be fully beholden to its union to get in line and plead - it is not difficult for anyone who has ever negotiated labor contracts to imagine the price possibilities the union will extract for its permission to apply. By this statutory definition, people outside the bargaining unit who lose their jobs, can not apply - and non-union

companies would be shut out altogether even for their wage employees as the Bill is currently drafted. I can not recall any other Federal legislation which proposes to provide taxpayer subsidies to individual companies, and then requires that all future applicants must be represented by, and his company must secure the permission of, a union - even if it doesn't have one!

The important contributions and best public policy change that the Congress can make to assure a healthy and competitive domestic steel industry are these: Amend the ERISA law - extend The President's Trade Program and reestablish more competitive capital recovery times for heavy industry.

We see no value and much to lose if this proposed legislation is passed. How does a Federal government deeply in debt, and gravely concerned with reducing the Federal Deficit, help that problem by assuming the pension risks of private steel companies also deeply in debt?

Consider this even if no other truth is acknowledged - to what purpose are steel jobs to be saved by public subsidies? Whose customers will failed but born-again steel companies take? This legislation will not create any demand for one single additional pound of steel. We already have modern steel plants like our Texas Works which are idle because there is simply not enough product demand, long term, to justify restarting them. When the government or the union, or Chapter 11 subsidizes

inefficient producers, it simply moves tonnage off the mills of efficient producers who are paying the full tab, and sends the jobs to subsidized and bankrupt companies - the netting out to employment is zero. It is not a good Bill. For the reasons discussed, we could never support this legislation.

Senator METZENBAUM. Mr. Jenkins? Mr. Jenkins is the Vice President for International Affairs and Government Relations of Armco.

Mr. JENKINS. Thank you, Mr. Chairman.

Before I start, I would like to express my disappointment and surprise at the comments by my distinguished colleague from USX. I say that because only a few months ago, AISI, which is chaired by the President of United States Steel, issued a release, a document, policy paper, which I would like to submit for the record with your permission, sir——

Senator METZENBAUM. Without objection, it will be included in the record.[1]

Mr. JENKINS [continuing]. Which described these problems and specifically suggested, for example, that we believe one feasible approach might be creation of a steel restructuring fund under Government auspices to deal with the industry's pension burdens.

We had a roughly 1-year consensus-building exercise in AISI on the industry's problems, and this approach was agreed to and approved by all the major companies in AISI at that time.

I recognize the substance of what Bruce has said, but I do think it is important to realize that there is a widespread consensus within the industry which, until very recently, included United States Steel.

I want to thank you and your splendid staff for the work they have done on these efforts and on this bill and for the opportunity to testify on behalf of S. 1811. Armco strongly endorses this bill.

We believe this legislation will inhibit additional steel bankruptcies as well as reduce considerably the underfunded position of the industry's pensions. Over the past 5 years, over 25 percent of the capacity of the industry has been shut down, and the industry has suffered some $12 billion in losses.

As a result, an estimated $8 billion unfunded pension liability has been created. The burden of paying for those shutdown costs has been a major contributor to the fact that over 20 percent of the companies in the steel industry today are in bankruptcy. In fact, protection under the Bankruptcy Code has become a key strategic tool to achieve restructuring goals.

I might say here that I strongly endorse the suggestion by Bruce that bankruptcy legislation might be reviewed and perhaps corrected, but I think no one knows better than you do, sir, how complicated and what a long project that would be. We are looking at today's problem for an industry and its workers, not something within the next 3 to 4 years.

Unfortunately, bankruptcy is the most inefficient means of accomplishing restructuring. It rewards the inefficient with marketplace advantages of some $75 per ton over those companies which have met their responsibilities. The widely held view today, expressed again this morning by Secretary Whitfield, would have us believe the steel industry's problems have passed. Business Week a few weeks ago trumpeted "Call off the funeral. They are all showing profits." We are showing profits. However, a large portion of

[1] See p. 150.

the profits being shown today are directly related to the one-time investment tax credit carry-back provided for in the Tax Reform Act of 1987. That is a benefit enjoyed by all of us here at this table.

In fact, we are at the peak of the economic cycle for steel, and operating results are still barely better than break-even. I emphasize—operating results. We must do better than barely better than break-even to restore our research capabilities, complete the conversion to continuous casting, and translate and consolidate our already impressive gains in productivity into marketplace competitiveness.

Virtually every steel-producing nation of the world manages their steel industry to target our markets in the United States. They also control reduction of capacity, and they subsidize the expensive human costs associated with capacity shutdown.

The European community, for example, provided almost $37 billion to the steel industry under the community's aid codes that were in effect from 1980 to 1985—and they are still in effect. These codes included: a plant closure premium, job elimination assistance, and social back-up measures. Similar benefits in the form of socialized national health benefits and other social costs are a standard feature in Japan. Other major steel competitors in the crowded U.S. market, such as Brazil and Korea, are State-owned industries.

Recently, a Japanese Embassy officer addressing a group of us at NAM bragged that Japan's coke oven industry had just been shut down because it was no longer world-competitive. Asked how the industry paid for the pension and health costs for such a massive shutdown, he blithely replied: "Oh, those are all taken care of by the Government."

Mr. Chairman, we do not seek State subsidies or nationalization of our health costs, but rather, a creative partnership which allows us to continue our modernization at no significant cost to the U.S. budget.

S. 1811 would offer us a chance to get out ahead of the power curve of the next crisis—the scenario which Senator Quayle and Senator Heinz have laid out about the future of the steel industry.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you very much, Mr. Jenkins.

[The prepared statement of Mr. Jenkins follows:]

TESTIMONY OF KEMPTON B. JENKINS

LABOR SUBCOMMITTEE

SENATE COMMITEE ON LABOR AND HUMAN RESOURCES

NOVEMBER 20, 1987

1

Mr. Chairman, my name is Kempton B. Jenkins and I am Corporate Vice President of Armco, Inc. I want to thank you for the opportunity to testify on behalf of S.1811, the "Steel Retirement Benefits Funding Act of 1987". Armco strongly endorses this bill, introduced by you and Senator Heinz and cosponsored by seven other Senators. S.1811 allows the steel industry to remove from its pension trust a substantial portion of its pension liabilities then refinance them through an alternative mechanism. I'll not attempt to describe this mechanism as I'm sure you will hear considerably more about this from the final panel today.

We believe this legislation would inhibit additional steel bankruptcies as well as reduce considerably the underfunded position of the steel industry's pensions.

Over the past five years, the problems the domestic steel industry has faced have been unprecedented. Since 1981, employment is down fifty percent (from 500,000 to 250,000 employees), over 25% of the capacity of the industry has been shut down (from 154 to 112 million tons), and the industry has suffered some $12 billion in losses. In addition an estimated $5.0 to $8.0 billion unfunded pension liability has resulted.

As a result of the dramatic reductions of capacity and employment outlined above, the steel industry has been forced to absorb extraordinary costs associated with the shutdowns of its facilities,

and there is more to come. To operate at maximum efficiency, another 20 million tons of capacity in out-dated facilities will eventually have to be removed from operation. The burden of paying for what we have already done has been a major contributor to the fact that over 20% of the companies in the steel industry today are bankrupt. In fact, protection under the bankruptcy code has become a key strategic tool to achieve restructuring goals. Unfortunately, bankruptcy is the most inefficient means of accomplishing these restructuring goals. It is costly to the federal government and costly to the companies. It is inequitable in that the weakest companies are the most greatly advantaged and most importantly it is tremendously unfair to the individuals who are counting on the security of their pension plans.

S.1811 would allow companies to accomplish their restructuring plans without the necessity of protection under the bankruptcy code and the termination of its pension plans. I often hear the comment that a government fund such as this sets a bad precedent, that the federal government should not inject itself into the free enterprise system; let the companies declare bankruptcy. This argument is simplistic and dead wrong. The fact is, the federal government is already involved through the bankruptcy code itself, and in a way that does the most to discourage free enterprise. Through the bankruptcy code and the PBGC, those companies which gain the greatest advantage are those which have the most underfunded pension plans. My point here is, the bad precedent has already been set. You now have the opportunity to provide an alternative to this

anti-marketplace situation, one which is more equitable, less traumatic, considerably less expensive and much more free-enterprise in its impact.

A second misconception I commonly hear, is that the steel industry's problems have passed. "They are all showing profits!" You are right, in that we are showing profits. However, you must realize a considerable portion of the profits being shown are directly related to the Investment Tax Credit carryback provided for in the Tax Reform Act of 1987. In fact, we are at the peak of the economic cycle for steel and operating results are only slightly better than break-even. The attachment illustrates that net income for four major producers (Armco, Bethlehem, Inland and National) showed a total of 300+ for nine months of this year. However, when the ITC and other special credits are removed it drops to a total of only $33 million for all four! We all know today's full capacity booking can and will not last. Steel is cyclical. When the downturn occurs we will once again be faced with the problems we have faced over the past few years. During the brief respite we are now experiencing, it is essential that the industry go as far as possible toward accomplishing the greatest possible streamlining and financial health in order to face the reality of our global marketplace. The modest earnings we are currently showing will not do that. We must do better than "slightly better than breakeven" to restore our research capabilities, complete the conversion to continuous casting, and translate our already impressive gains in productivity into marketplace competitiveness. The massive pension burden we now bear, as a result of the

industry-wide decline of the last decade, must be eased if we are to achieve health and avoid eventual industry collapse.

Rather than viewing the current earnings situation of the industry as a reason not to move forward with S.1811, you should look at it as a small window of opportunity in which a substantial assist, at very little (if any) cost to the U.S. Government, will assure that you will not be faced with providing major subsidies in the future. We all believe that in time, the domestic steel industry will survive and even thrive; it's just a question of how we get there -- through the costly, inefficient, inequitable and traumatic bankruptcy code which dumps the pension burden on the PBGC; or by managing the change that will take place in an orderly, efficient and inexpensive manner.

Virtually every steel producing nation of the world manages their steel industry to target our markets. Included in the management of the industry is the controlled reduction of capacity and the subsidy of the human costs associated with shutdown.

The E.C. Commission's July 31, 1987 proposals taken as a whole represent an enormous, governmentally financed rescue operation for the E.C. steel industry whose total cost, if the proposals are implemented, is estimated to be in the range of $5.5-6.5 billion (more on this calculation below). This input of resources into steel would, moreover, follow almost $37 billion provided to the E.C. industry under the Community's "aid codes" that were in effect from February 1980 until December 31, 1985. These codes included:

1. A plant closure premium to be paid to companies who would undertake the "irrevocable and permanent" closure of capacity for wide hot-rolled strip, plate and heavy structurals.

2. Job elimination assistance to companies (by grants or allowances for workers being redeployed, or made redundant or to assist re-employment).

3. "Social back-up measures", consisting of: income support grants during first 18 months of unemployment, re-employment or early retirement, vocational training grants; "mobility" grants; and supplementary early retirement and re-employment aid.

Similar benefits in the form of socialized national health benefits and other "social costs" are a standard feature in Japan. Other major steel competitors in the crowded U.S. market such as Brazil and Korea are state-owned and do not have to concern themselves wtih "social-costs".

We do not seek state subsidies, or nationalization of our health costs -- but rather a creative partnership which allows us to continue our modernization at no cost to the U.S. budget.

I reiterate Armco's support for S.1811 and encourage the Congress to pass this needed legislation. It is good legislation, at an appropriate time, in the appropriate amount.

9 Months 1987 Net Income Performance By Four "Purest" Major Steel Producers

	9 Mos. 87 Net Income (mil. $)	ITC Cashouts Claimed to Date (mil. $)	Balance (mil. $)
Armco	$ 88.8	$ 41.7	$ 47.1
Bethlehem	102.8	97.5	5.3
Inland	85.5	50.0	35.5
National Steel*	25.2	18.0	7.2
	$302.3	$207.2	$ 95.1

*Not NII

Almost 70% of the 1987 net income claimed to date by the four major steel producers with the "purest" steel related earnings are the result of ITC cashouts. Further, the USS division of USX (pure steel) has a negative $82 million operating income through 9 mos. 87 due to heavy strike related losses in 1Q87 ($192.0).

Additional Adjustments

	9 Mos. 1987 (mil. $)
Armco	
Credit for favorable U.S. Tax Court Ruling	$14.7
Extraordinary gain for retirement of debt	9.1
Tax benefit of loss carryforwards	17.4
(No report on LIFO adjustments)	
	$41.2
Inland	
Tax benefit of loss carryforwards	9.1
(No report on LIFO adjustments)	
National	
None reported (Reporting is very incomplete)	
Bethlehem	
LIFO Inventory Liquidation Credits	12.0
Subtotal	$62.3

Senator METZENBAUM. The last witness on this panel is Mr. Stanley Ellspermann, Senior Vice President, National Steel Corporation of Pittsburgh.

Mr. Ellspermann.

Mr. ELLSPERMANN. Mr. Chairman and Members of the Committee, good morning and thank you for the opportunity to testify today.

National Steel supports S. 1811 because it helps to create an environment in which steel companies can continue their recovery without placing a large financial burden on the taxpayers or on other sectors of the industry.

The bill accomplishes this by encouraging steel companies to avoid Chapter 11 bankruptcy and by controlling the cost of downsizing so that pension plan considerations alone will not determine the future of our industry.

In addition, we believe the bill will encourage Congress to act with restraint on the various pension reform bills which are now under consideration.

Clearly, it is no secret that in the steel industry in the United States and throughout the world for that matter, there is excess capacity. For our steel companies to continue to exist, they must have an economically viable means of reducing capacity and increasing efficiency. The bill provides at least a mechanism for this to occur.

Also, the bill creates a positive legislative environment for the steel industry. There are currently four proposed laws in Congress dealing with PBGC premiums and the minimum funding standards required of corporate pension plans.

If the more extreme of these bills is passed, it could drive up the cost of steel pension plans significantly and perhaps even force some steel companies into bankruptcy. We believe that this bill will relieve the PBGC of some of its burden by reducing the probability that major steel companies will go bankrupt in the future. This reduction in future bankruptcy risk should allow Congress to adopt one of the more modest bills.

It is true that National Steel will benefit less from this than many other steel companies. National's pension plan is adequately funded; it has fewer retirees in proportion to active employees than most steel companies; and because it has modern plants, it has closed almost no facilities.

In fact, in 1983, National encouraged the formation of an innovative employee stock ownership plan for one of its divisions, Weirton Steel. Today that ESOP is operating profitably.

National chose to find a way to handle its responsibilities rather than pass them along to the Government.

However, the threat of Chapter 11 bankruptcy by others in the steel industry has a direct negative impact upon National Steel. We have already seen that bankruptcy provides a competitive advantage in the marketplace for those companies who declare Chapter 11. For example, steel industry analysts have placed the per-ton savings for those steel companies in bankruptcy at up to $75 a ton, and believe me, that is a significant and overwhelming advantage.

We must also address the area of employees' rights. National believes there is a bond of interdependency between a company and

its employees. Both National Steel and the United Steelworkers of America felt strongly enough about this to write a specific section on Cooperative Partnership into its most recent labor agreement. National believes in that cooperative partnership and in the rights of its employees, and those rights include protection of employees' pensions.

If Congress can feel confident that a combination of 1811 and a more moderate PBGC bill will work, not only in the interest of the steel industry but also in the interest of the PBGC and the country as a whole, then we think that such a combination would be advisable.

To conclude, we estimate the bill reduces the risk of bankruptcy due to steel company pension plans. In addition, it provides financial incentives to steel companies to avoid Chapter 11 bankruptcy, and in the end will enable steel companies to fund their own pension plans with their own profits. As a result, the effect of the bill will be to relieve some potential pressure from the PBGC and reduce the funding requirements in the future for that institution.

Thank you again for the opportunity to testify.

Senator METZENBAUM. Thank you, Mr. Ellspermann.

[The prepared statement of Mr. Ellspermann follows:]

TESTIMONY

OF

STANLEY C. ELLSPERMANN
SENIOR VICE PRESIDENT-ADMINISTRATION
NATIONAL INTERGROUP, INC.

before the

Senate Subcommittee on Labor and Human Resources

on

Steel Retirement Benefits Funding Act of 1987
(S.1811)

November 20, 1987
Washington, D. C.

Members of the Committee. Thank you for the opportunity to testify today.

I am Stan Ellspermann, a senior vice president at National Intergroup, Inc., one of two parent companies of National Steel Corporation. Prior to joining National Intergroup, I was a senior vice president with National Steel. I am currently serving on National Steel's Board of Directors.

National Steel supports Senate Bill 1811, the Steel Retirement Benefits Funding Act of 1987. Gentlemen, we commend you for your efforts and creative approach in dealing with the question of pension security for the steel industry. We also applaud those efforts that you previously made on S.548, a bill designed to protect the health and life insurance benefits of employees in the steel industry.

We support S.1811 because it helps to create an environment in which steel companies can continue their recovery and progress on their road to financial health without placing a large financial burden on the taxpayer or on other sectors of industry. S.1811 accomplishes this by encouraging steel companies to avoid Chapter 11 bankruptcy and by easing the cost of downsizing so that pension plan considerations alone will not determine the future of our industry. In addition, we believe this measure will encourage Congress to act with restraint on the various pension reform bills which are now under consideration.

It is no secret that the steel industry in the United States, and throughout the world, has excess capacity. For our steel companies to continue to exist, they have had to reduce capacity and increase efficiency. S. 1811 eases the heavy financial burden of that effort. In effect, S.1811 helps prevent the

cost of a steel company's pension plan from driving it out of business. For this reason, we support the legislation pending before you.

S.1811 also creates a positive legislative environment for the steel industry. Currently, there are four proposed laws in Congress dealing with PBGC premiums and the minimum funding standards required of corporate pension plans. If the more extreme of these bills is passed, it could drive up the cost of steel pension plans significantly and perhaps even force some steel companies into bankruptcy. This would place a tremendous burden on the PBGC. We believe that S.1811 would aid in reducing the probability of major steel companies going bankrupt in the future. This reduction in future bankruptcy risks will give Congress the latitude to adopt one of the more modest of the four bills introduced respectively by the House Ways and Means Committee, the Senate Finance Committee, the House Education and Labor Committee, and the Senate Labor and Human Resources Committee. If one of the more modest bills is adopted, it will, in turn, help the economic future of steel companies.

It is true that National Steel will benefit less than some of the other steel companies from the provisions of S.1811. National's pension plan is adequately funded, it has fewer retirees in proportion to active employees than most other steel companies, it has modern plants, and it has closed almost no facilities. In fact, in 1983, National Steel encouraged the formation of an innovative employee stock ownership plan for one of its divisions, Weirton Steel. Today that ESOP is operating profitably. Though National has chosen to find a way to handle its responsibilities, rather than attempting to pass them on to the government, the threat of Chapter 11 bankruptcy by others in the steel industry has a direct negative impact upon National Steel

We have already seen that bankruptcy provides a competitive advantage in the marketplace to those companies who declare Chapter 11. For example, steel industry analysts have placed the per-ton

savings for those steel companies in bankruptcy at up to $75 a ton. Transferred into the marketplace, where prices continue to hover around 1981-82 levels ... and when the average selling price of a ton of steel is around $450-$460, $75 a ton can be an overwhelming advantage.

Bankruptcy also affects the area of employees' rights. National believes there is a bond of interdependency between a company and its employees. Both National Steel and the United Steelworkers of America felt strongly enough about this interdependency to write a specific section on Cooperative Partnership into its most recent labor agreement. That labor agreement guarantees National's workers employment security through the end of the current contract. It also provides for profit sharing and productivity/gainsharing bonuses based upon the performance and profitability of the corporation. National Steel believes in its Cooperative Partnership and the rights of its employees. Those rights include the protection of employees' pensions.

For 1987, National Steel's contributions to its pension plans will be $39 million. In addition, National has paid 1987 PBGC premiums of approximately $300,000. For 1987, National Steel expects to earn a profit of between $16 and $21 million. This will be only the second profitable year for National in the past seven. If the most extreme of the four proposed pension bills is adopted, National Steel's 1987 contribution could be as much as $111 million, with a PBGC premium of $3 million. This proposal thus would erase any profit National Steel can expect to earn during 1987 and, in fact, would create a significant operating loss.

If, on the other hand, one of the more moderate proposals were adopted, National Steel's 1987 contribution could be expected to be about $50 million and its PBGC premium would increase to about $700,000. These figures are more realistic to the continued financial viability of our company. Therefore, if Congress can feel confident that a combination of S.1811 and a more moderate PBGC

bill will work, not only is it in the best interest of the steel industry, but also in the best interest of the PBGC and the country as a whole. National would encourage and support such a combination.

To conclude, we estimate that S.1811 reduces the risk of bankruptcy facing steel companies because of their pension obligations. In addition, S.1811 provides additional financial incentives to steel companies to avoid Chapter 11 bankruptcy and encourages these companies to fund their own pension plans with profits. As a result, the effect of this legislation will be to relieve some potential pressure from the PBGC and to reduce the funding requirements in the future for that institution. This relief will enable Congress to pass one of the less extreme PBGC bills which it is now considering.

In essence, S.1811 creates an environment that will help steel companies to recover. Should this bill not pass, there may be potentially serious consequences for the steel industry and, subsequently, other industries and the country as a whole.

Once again, thank you for this opportunity to give testimony. I will be happy to answer any questions.

Senator METZENBAUM. Mr. Williams, there are those who argue that the existence of the PBGC makes a bankruptcy filing nearly painless for workers. Do you feel that is a true statement?

Mr. WILLIAMS. No. It certainly, Senator, is not a painless process for workers at all. It threatens their supplementary pensions, for example, which have been the chief mechanism available for all of the reasons you have been hearing this morning, available for workers in terms of adjusting to this devastation in the steel industry, and the PBGC does not support the supplementary pensions. That is the difference for many of the workers in having some opportunity to continue some kind of decent living standard. And obviously it hurts the active workers. There is a great contention between ourselves and the PBGC, as you know, about the kind of continuing pensions that should or should not be permitted. But even what we have been able to do is much less adequate than the defined benefit plans that the Chapter 11 process has eliminated as the pension plans have been eliminated.

So, Chapter 11 is no picnic for the workers; and then, of course, it involves the whole question of renegotiating the collective agreement normally, and in each case that has represented enormous difficulties—in all of the cases, not in each case; I was thinking of Wheeling-Pitt and LTV particularly, but there are all these other cases that you have heard about, too. So, it is no picnic.

Senator METZENBAUM. Thank you very much.

Mr. Johnston, you oppose the bill, and you claim that Congress should simply prohibit the termination of pension plans in Chapter 11, requiring companies to liquidate before they can terminate an underfunded plan.

In effect, you are telling your competitors to close their doors, throw thousands of workers into the streets, and substantially reduce the amount of competition you will face.

Despite the pension proposals reported from the Finance and Ways and Means Committees, the Bankruptcy Code would have to be amended to accomplish that objective.

I can tell you as a Member of the Judiciary Committee we are not going to do that.

My question is, would you prefer to have your competitors follow the lead of LTV and use bankruptcy as a way of shedding their pension obligations, or would you prefer that a mechanism be established to help refinance them? And I also hope you would answer as to whether or not you are concerned about the fact that the elimination of several steel companies will create a monopoly market for the very few who would be left, yours being the largest of the group. Whether or not that actually is good for the American economy.

Mr. JOHNSTON. As best I can do in the order presented. First I would like to correct one portion of the record. There is no AISI position on this bill or AISI testimony offered on this bill. United States Steel has never been part of any consensus in support of this bill. AISI has indeed studied—and we do chair the AISI—the possibility of some Government help in future closings, but there is no AISI position on this bill.

Senator METZENBAUM. The hearing will remain open long enough to hear directly from the AISI as to what position, if any,

they have in connection with this. We do have a letter dated February 6, 1987, indicating their position paper—it is too long for me to read at this point, but we will include it in the record, and if there is anything further the AISI wants to include, we will include that in the record as well.

[The letter referred to above follows:]

American Iron and Steel Institute

1000 16th Street N.W., Washington, D.C. 20036

Thomas C. Graham
Chairman

CONFIDENTIAL

February 6, 1987

The Honorable Bruce Smart
The Under Secretary of Commerce
International Trade Administration
United States Department of Commerce
14th and Constitution Avenue, N.W.
Room 3850
Washington, D.C. 20230

Dear Mr. Smart:

On behalf of the domestic members of the American Iron and Steel Institute I transmit the attached position paper on the revitalization of the American steel industry and the government policies we believe are appropriate to help achieve it.

The paper summarizes the key elements in the present steel crisis and suggests new public policies to deal with three key issues: restructuring, modernization and trade.

On restructuring, the paper addresses the need to eliminate an estimated 30 million tons of excess capacity. To achieve this, there must be removed the main obstacles to further capacity reduction, namely the huge funding requirements for pensions and other exit costs, the problem of income statement and balance sheet effects of plant closures, and the problems created by the Chapter 11 bankruptcy process.

We believe one feasible approach to restructuring might be the creation under government auspices of a Steel Restructuring Fund. The Fund's resources could be provided at no cost to the Treasury by, for example, levying a surcharge on steel imports. Companies could apply to the Fund for resources to accomplish capacity reductions according to specified conditions, including physical demolition of facilities. They would also be expected to agree to some form of repayment, for example by relinquishing NOL tax benefits.

On modernization, the paper indicates that the industry must spend $2 billion more annually than it has been spending in order to modernize at least up to the level of its principal foreign competitors.

On trade, with total U.S. steel demand stabilized during the 1980's at roughly 100 million tons, and with direct and indirect steel imports now supplying over one-third of that demand, the paper suggests means of strengthening the President's Steel Program so that steel import policies further contribute to the revitalization process.

We are available to review the paper with you and to discuss any alternatives you feel may be as effective in accomplishing the revitalization of our industry.

Sincerely,

Tom Graham

CONFIDENTIAL

2/6/87

GOVERNMENT POLICIES TO REVITALIZE AMERICAN STEEL

I. Background

The domestic steel industry is experiencing massive financial losses, and a number of major companies are rapidly liquidating. This is the result of several factors.

1. There is world overcapacity in steel producing facilities, on the order of 250 million metric raw steel tons. In the United States, there is substantial overcapacity in both steel production and finishing facilities and in iron ore pellet production facilities.

2. Over the last five years, domestic steel demand has remained more or less stable at around 100 million tons (see Exhibit 1). But steel mill product imports have sharply increased (from 14.3 million tons in 1976 to 24.3 million tons by 1985), and indirect steel imports have likewise soared (from 8.3 million tons to 16.9 million over the same period). This huge surge in direct and indirect steel imports, combined with sharply falling prices, profitability and cash flow has caused our producers to shut down 35 million tons of raw steel capacity (well over a fifth of the 154 million tons in place in 1981). Of the capacity remaining (119 million tons currently) only some 90 million tons has in fact been operated, to support roughly 70 million tons of product shipped. Thus, even huge capacity cuts over the last five years have still left substantial unused facilities on companies' books.

Plant closings on this massive scale have subjected the companies to an enormous burden of ongoing pension, health and other retiree benefit costs. This burden has had to be carried by an industry whose production, work force, sales and cash flow are continually shrinking (the ratio of active workers to retirees, for example, has gone from 2.3 in 1977 to .5 in 1986).

In addition, the huge debt that was incurred by the industry in its efforts to survive and modernize (debt-to-equity ratio rose from 42% in 1981 to 105% in 1985, with debt currently over $8 billion) now has to be serviced by a sharply reduced base of sales and cash flow.

3. Imports remain at very high levels. Despite the good intention of the President's Steel Program, imports have been 20% above the program's "expected result." These levels are the result of the huge worldwide overcapacity, continuing foreign government subsidization, and unfavorable exchange rates - which add up to continued and increased dumping.

On the basis that implementation of the President's Steel Program would cut back the foreign share of the U.S. market and improve the industry's profits and cashflows, the domestic industry committed to modernize and compete against the world. The cutback in import market share has not materialized, however, as increased indirect steel imports have more than offset cuts in direct imports.

The industry's efforts to deal with these problems have included, in addition to capacity reductions:

- reduction of the work force by 55% since 1981 (from 391,000 in 1981 to 176,000 in 1986);
- negotiation of concessionary labor contracts in 1983 and 1986;
- drastic reductions in salaried personnel and their compensation;
- $7 billion of investments since 1982 despite cash flow from steel operations of only $2.6 billion; and
- improvements in productivity, as measured by manhours per ton, to a level at least equal to that of the efficient steel industries of West Germany and Japan.

However, these measures have failed to stop the liquidation process, which is now accelerating. There have been over $12 billion of losses since 1982, and 20% of industry capacity is now in bankruptcy. More may follow.

It is obvious that further restructuring and modernization of the remaining capacity is essential in order to operate internationally competitive steel facilities in the U.S. and maintain them as part of our nation's industrial base. And it is also clear that the President's Steel Program has not yet fully dealt with the steel trade problem. New public policies are thus needed to deal with these three key issues: restructuring, modernization and trade.

II. Restructuring

Restructuring requires, first and foremost, elimination of the industry's excess capacity, estimated to be about 30 million tons. But this process is being hampered by three main obstacles.

First, huge funding over many years is required for plant closures. These cash costs result from actuarial increases in pension costs, the continuation of health care and life insurance, the settlement of large "take or pay" contracts, severance costs associated with closings or staff reductions, and environmental costs due to facility closings. These costs must, of course, be borne by a shrunken base of earnings.

Second, plant shutdowns have income statement and balance sheet impacts resulting immediately in unfavorable changes in key financial indicators, causing downgrading of a company's credit rating and, possibly, defaults prompting punitive actions by the financial community. Unfunded pension and other employment liabilities are by far the largest concern in this regard. The result is to throw up further barriers to additional restructuring.

Chapter 11 bankruptcy is a third obstacle. It is designed to preserve individual companies. It was not intended to be, and is not, appropriate for restructuring an entire industry. Capacity shrinkage resulting from company bankruptcies happens slowly or not at all, with the effect that more firms are drawn into Chapter 11 - and, indeed, may feel obligated to do so in order to avoid being competitively disadvantaged.

In addition, to the extent restructuring would involve mergers, acquisitions or joint ventures, there has been uncertainty as to how the antitrust laws would be interpreted and applied.

In order to reduce the impact of the inevitable restructuring of the domestic steel industry on the national economy and the government, and to facilitate that restructuring, government assistance is essential.

The specific goals would be:

- to reduce excess iron and steel and iron ore production capacities;
- to prevent further company bankruptcies;
- to establish conditions for an adequate return on capital investment, so as to permit modernization of the industry;
- to continue to provide employment opportunities; and
- to assure steel retirees their pension and health benefits.

Accordingly, the following public policy positions should be implemented:

A. Capacity Reduction

The domestic industry's restructuring should be carried out in a manner which meets the following criteria:

(i) The restructuring procedures must ensure that the domestic industry regains international competitiveness faster and more economically than would occur if no government measures were taken and the present drift into the Chapter 11 process continued.

(ii) The restructuring procedures must not disadvantage more efficient producers vis-a-vis the less efficient.

(iii) Closed facilities must be expeditiously demolished, so that they are not subsequently revived, thereby recreating overcapacity.

(iv) The costs of restructuring must place minimum burden on the U.S. taxpayer and interfere as little as possible with market forces.

(v) The measures must facilitate availability of funds when and as needed for restructuring.

(vi) Benefits must be used by participating companies first for directly-related human costs associated with recent and future restructuring, and then for other exit costs, including environmental costs. To the extent resources remained, they could be used for modernization, but in no event for expansion of capacity.

(vii) Companies participating in a restructuring program must agree to some form of repayment (e.g., relinquishing an equivalent dollar sum of NOLs).

(viii) The measures should be politically acceptable from the government's standpoint, and therefore limit any budgetary impact to as far out into the future as possible, involve the lowest cash outlays, be reasonably consistent with government international trade policies, and alleviate government concern over large PBGC liabilities.

We believe one feasible approach might be creation of a Steel Restructuring Fund (SRF) under government auspices. SRF's resources could be provided, at no cost to the U.S. Treasury, by, for example, levying an ad valorem surcharge on steel imports (a 10% rate would yield on the order of $800 million annually). The rationale for this surcharge would be (a) the cumulative and continuing damage to the industry of years of unfair trading into the U.S. market over and above the injury partially mitigated by VRA's or other relief and (b) the need to ensure the competitiveness of the domestic steel industry vis-a-vis its foreign competitors, most of whose restructurings have been, or are being, massively subsidized by their governments.

Companies could apply to SRF for resources to accomplish the objectives and priorities stated above, with less serious adverse consequences to their balance sheets.

A formula would be developed to assure equitable benefit distribution to each participating company; disbursements would be related to shutdowns and be conditional upon physical demolition of facilities.

Other means of providing resources related to restructuring may be appropriate.

B. Supplementary Government Policies

- The Federal and state governments must refrain from funding directly or indirectly actions by steel companies, labor unions or communities to perpetuate uneconomic steel producing facilities (e.g. UDAG grants that extend the life of abandoned operations).

- Government actions should be focused on efforts to assist workers on lay-offs and local communities affected by plant closings:

- Provide retraining benefits to employees on lay-off because of shutdowns.

- Encourage local communities to accept steel capacity reductions by providing assistance to workers and communities that are affected.

o State governments should be discouraged from uneconomic competition in providing incentives for new steel investments.

III. Modernization

The industry must modernize at least up to the level of its principal foreign competitors. The modernization problem, however, is not one of obtaining access to the latest technologies, which continue to be readily available from domestic and foreign sources, but of having enough resources to do so. In recent years, domestic producers' ongoing spending for modernization has been about $2 billion annually. Given the contemplated reduced industry capacity an additional $2 billion annually must be spent for ongoing modernization.

Two related problems must also be addressed: (1) the need to increase R&D expenditures to a level at least equal to 1% of sales, in order to maintain competitiveness of the domestic industry; and (2) the need to keep new construction costs as competitive as possible with those of foreign producers. (For integrated production, U.S. costs are currently about $1700 per ton of installed capacity, compared with foreign costs ranging from $500-1300 per ton. For specialty and mini-mill production the discrepancy between foreign and U.S. costs - the latter estimated at $750/ton for specialty and $350/ton for mini-mills - is not as great but is believed appreciable.).

Accordingly the following public policy positions should be implemented:

1. Establish incentives (and remove any obstacles) so that domestic producers' R&D expenditures can rise to at least 1% of companies' sales volume, and such projects as the Steel Industry/Federal Laboratories Initiative and cooperative research (e.g. the new AISI-Northwestern University Steel Resource Center) can proceed as expeditiously as possible.

2. Correct laws that tend to increase artificially the costs of new construction for the steel industry.

IV. Trade

The President's Steel Program was established to deal with the trade problem, but it is falling short of its "expected result" of 18.5% import penetration for finished products. This target was exceeded by roughly 5

percentage points in 1985 and 3 percentage points in 1986. The program's limit of 1.7 million tons of semi-finished imports has also been exceeded by some 30% so far, with the result that huge investments by domestic integrated producers in primary steelmaking facilities have become vulnerable to unfairly traded semifinished products. Imports from uncovered countries (especially Canada, Sweden and Taiwan) have surged to over 5% of the market, and further surges and circumvention schemes pose a continuing threat to the success of the Program.

Two additional trade problems require attention: prices of imported steel have failed to reflect sharp increases in some foreign producers' dollar equivalent costs resulting from recent exchange rate shifts, and indirect steel imports continue to surge (1986 16.9 million tons).

Accordingly, the following government actions should be implemented:

1. Take all measures necessary, including, particularly, the use of government-initiated trade cases and strengthening the U.S. Customs Service's enforcement capability, so as to (i) bring uncovered countries into the President's Steel Program, (ii) ensure coverage of all specialty steel products either by VRAs or Section 201 relief as extended and (iii) ensure that the "expected result" of the Program is in fact achieved (18.5% import penetration for finished products; 1.7 million tons import limit for semi-finished).

2. Extend the President's Steel Program until the Program's expected result has been achieved on average over five consecutive years.

3. Maintain strict standards for "short supply" exceptions to import limitations and offset any such exceptions against VRA's of the country involved for related products.

4. Monitor import prices in relation to exchange rates; take government-initiated trade case action where appropriate so as to deter dumping; and permit domestic producers to file trade cases without terminating VRAs.

5. Make every effort to cause foreign governments to eliminate steel trade-distorting subsidies and to ensure restructuring of their domestic steel industries, and convince other OECD governments to ban all forms of financing support for exports of steelmaking equipment. If foreign governments do not prohibit such export subsidies, the U.S. should lend financial support to exports of U.S. plant and equipment.

6. Proceed with trade law reforms, including: increased protection against unfair trade by diversion (e.g. "diversionary dumping" and "upstream" subsidization); establishment of clear guidelines on "cumulation" in determination of injury to domestic industry; and provisions for a viable private damages remedy for dumping.

7. Implement macroeconomic policies to stimulate demand for steel and basic industry in general; strengthen Buy American provisions at the federal and state level; and stimulate transportation infrastructure rebuilding and capital goods investment.

8. Carefully examine the factors behind currency exchange rates for those countries which in recent years have simultaneously rapidly expanded trade surpluses with the U.S. while their currency values relative to the U.S. dollar have declined. Take actions as appropriate based on these findings.

9. Determine the factors with respect to subsidization, dumping and targeting behind the rapid surge in imports of steel intensive products. Commit to self-initiate anti-dumping/countervailing cases where appropriate and work with industry and labor on joint efforts to arrest and turn around this destructive trend in downstream products.

EXHIBIT 1

Total Steel Demand in the U.S.
(Millions of Tons)

	1 U.S. Mill Shipments (excl. exports)[1]	+	2 Imports of Steel Mill Products[2]	+	3 Indirect Steel Imports[3]	=	4 Total U.S. Steel Demand	5 Total Imports % of Total Demand (2+3-4)
1980	79.8		15.5		9.6		104.9	23.9
1981	85.5		19.3		9.7		114.5	25.3
1982	59.7		16.2		9.6		85.5	30.2
1983	66.4		16.5		10.5		93.4	28.9
1984	72.8		25.0		13.8		111.6	34.8
1985	72.1		22.3		16.1		110.5	34.8
1986	69.0		19.2		16.9		105.1	34.3

1 AISI Annual Statistics. 1986 is estimate.

2 1980, AISI Annual Statistics. 1981-85, AISI Annual Statistics, adjusted to avoid double counting of semifinished imports. 1986 is estimate.

3 1980-83 and 1986 are estimates developed by Bethlehem Steel Corp. 1984-85 are from recent AISI reports using data compiled by the Bureau of the Census.

2/4/87

Mr. JOHNSTON. Senator, being faced with the possibility of monopoly is a problem we would love to have. I assume that all my competitors would like to take my customers, and if they do not, they probably should be sued by their shareholders. And under our market-competitive economy, we want to get all the customers we can get.

The fact of the matter is that when we were considering the possibility of a merger with National Steel, we were about 2 percent of the world market. We are about 15 percent of the domestic market. We have modern steel plants which are sitting idle that we do not have enough demand to re-start, like our Texas works. So there is no absence of capacity or competition.

Senator METZENBAUM. At what percentage of capacity is USX operating?

Mr. JOHNSTON. About 85 at the moment. We are enjoying a strong period.

Senator METZENBAUM. You are operating at 85 percent of capacity and you still have plants sitting idle?

Mr. JOHNSTON. Yes.

Senator METZENBAUM. That means that some are operating in excess of 100 percent?

Mr. JOHNSTON. Eighty-five percent of our operating capacity; we have idle plants. I did not include that in the 85-percent assessment.

Senator METZENBAUM. So you do not include those that are idle.

Mr. JOHNSTON. No. They are in long-term idle status, and that 85-percent number does not include that.

Senator METZENBAUM. I see.

Mr. JOHNSTON. I think the problem with Chapter 11 is exactly as I have heard discussed by almost all the panelists—a beleaguered steel company which has not funded its pensions over the years, but has used that money to do other things, include buy facilities, elects Chapter 11, is excused from all of its financial costs, which are enormous in a capital-intensive industry, and in conjunction then with dumping its pension problem on PBGC, enjoys two enormous advantages in the marketplace. We think the first should be shut off. We do not think that if you are going to stay operating, you should be excused from funding your pensions unless you are willing to put assets up and turn them to the PBGC's availability to satisfy that claim. I think you establish a dangerous precedent for all large pension administration companies if that hole is not plugged.

We believe that LTV at the moment is probably the most aggressive, has the most aggressive capital spending budget in the industry, while they are not servicing their debt or paying their pensions. We are doing both. And to the extent that those new facilities come on line, that imperils our facilities.

Senator Quayle asked earlier what do you think the cost is to the government. Under this bill if we were to utilize it—and we see no appeal in it for us, because we can avail ourselves of commercial lending markets—we could get $178 million a year. Over 10 years, that is $1.78 billion. That is the potential loss if assets, which are already highly leveraged, are pledged against that to this new agency and do not pay off.

But there is another cost, Senator Quayle, to taxpayers. To the extent that all the excess capacity is kept on line, long term, the industry never generates enough proceeds to keep any of the respective companies strong on their steel side. You have all the companies operating at half-rations, and that will endanger ultimately almost all the pension funds and almost all the viability of those companies. The market has to wash out excess capacity, and every time that occurs, there is naturally a great political effort on the part of those people who are going to be impacted to prevent that.

We say we share in supporting the PBGC arrangement, with modest modifications, to prevent company failures from destroying the pensions of the workers. We don't think the government should protect the assets of investors and risk-taking shareholders.

Senator METZENBAUM. Thank you very much, Mr. Johnston.

The Chair has a 5-minute rule on each of the Members, and I wanted to let you finish, but my time has expired.

Senator Quayle.

Senator QUAYLE. Thank you, Mr. Chairman.

Let me see if I can ascertain from our panel that if we do not pass the Heinz bill or something like that to provide this Authority, to provide an arrangement to help out on some of these underfunded liabilities and the shutdown costs and the past and future restructuring, are we really, as in the question, posed by the Chairman, going to see bankruptcies, and literally thousands and thousands of people out of work?

In other words, if we do not get this legislation, are you telling us that we are going to have more bankruptcies in the steel industry? We have heard Mr. Jenkins refer to that possibility. We have heard the term "potential bankruptcy" used many times today. I would like to know if you are willing to go on the record saying that, if we do not get this bill, there are going to be bankruptcies in the steel industry in the future, like the LTV case.

Mr. WILLIAMS. Senator, I do not mind starting in on that question. I do not want to present myself as having some kind of crystal ball that says what the future of the industry will be. But the fundamental question here is whether we are going to have a significant steel industry in the United States or not. This cannot be discussed in terms of kind of a normal flow of the market and of business, and let things go where they will because clearly, in terms of what has been happening, in any rational view, it seems to me, of the prospects out there, erosion and devastation will continue, and we will not have a steel industry.

Now, what this bill is a piece of, as we see it in the union, is a piece of trying to ensure that there is some opportunity for the American steel industry to revive and to grow and to be a significant element in our society in the years ahead. And, absent such a steel industry, we will not have the kind of powerful, productive and prosperous society that we have known. It is critical, as a number of the Senators, Senator Mikulski mentioned in her opening remarks this morning. So this is one piece of trying to ensure a future for the steel industry.

Senator QUAYLE. I do not dispute that statement. I strongly support the campaign to promote, reinvigorate, reestablish, and recommit to having a viable, competitive steel industry.

If the Government is going to intervene in perhaps an unprecedented way through this Authority, then there must be some real emergency reason for the intervention.

Are you saying that without this legislation, there are going to be other companies going bankrupt? If that is the case, shouldn't the Federal Government's position then be from a public policy point of view to help the companies that say they are going bankrupt unless they receive assistance? We have done that in the past—Chrysler, Penn Central, Lockheed, Continental—for example. Are we at the position of imminent bankruptcy without this legislation?

Mr. Barnette.

Mr. BARNETTE. May I respond to that in part, Senator?

Senator QUAYLE. Yes.

Mr. BARNETTE. Exhibits to testimony that I filed with the Committee, paint an unbelievable picture of this industry which has declined from 500,000 employees since 1974 to 170,000 today; in Bethlehem's case, from 120,000 to 35,000 today, and pension benefit payments from $5 million in 1974 to $500 million in 1986. It is a remarkable story.

History alone tells us that 25 companies and 20 percent of this industry have gone through these proceedings. There is a common misunderstanding—and I say this most respectfully, Senator Quayle, that there is no Federal policy with respect to these issues.

And I would submit, Senator, that there is a Federal policy. It is in effect to let the current laws work. And I believe this panel is suggesting to you that they are not working well at all. They are not achieving public policy objectives. They are not fostering a long term pro-competitive steel industry. They will not permit the required expenditures to take place over time to further modernize this industry.

This industry cannot be restructured through Chapter 7 liquidation. History tells us that does not work. Mills are reconstituted. They are far less efficient and less pro-competitive factors in the marketplace. So it is perhaps a lengthy way of attempting to respond for any single company. That would depend on the facts and circumstances of that particular company at any particular point in time, and we desperately want to preserve and maintain the retirement benefits of our retirees. We have no such plans to file such a petition today, and I am speaking only for Bethlehem.

Senator QUAYLE. I also want to preserve and maintain the retiree's benefits but I am not getting an answer to my question. It is a very straight-forward question. Without this legislation, are we going to see other bankruptcies? And if we are, then shouldn't that be a pre-condition to getting assistance from the Government? If we are not going to face bankruptcies, then should we be doing this?

That is the question. Let me ask the rest of the panel to answer this question. I am trying to get a resolution to this problem.

Mr. JENKINS. I do not think any of my colleagues or myself certainly can say that unless A, B, and C happen, we will in fact file under Chapter 11. The fact is that the record, which is eminently clear in the last 5 years, is you have had a string of bankruptcies for circumstances which are very similar to those extant today.

This in spite of the fact that we continue to operate at close to capacity. I share Bruce Johnston's point of view that there is additional shutdown challenge out there in front of us, and it is precisely the shutdown costs which are unique to the U.S. industry in our global marketplace. These costs inhibit us from shutting down excess capacity.

What we are suggesting, is substituting or providing a substitute for PBGC wherein the companies have to put some assets into the pot right up front.

Now, we are selling in the marketplace today, in competition with LTV, at a $75 per ton disadvantage because of their being in Chapter 11. While the industry is close to capacity, we can all handle that. But the minute there is even the slightest downturn, we will be confronting their capacity to take our business away because of the cost advantage as a result of Chapter 11. In short they will prevail because of Government intervention in the market process.

Senator, it is not a question of whether the Government should intervene; the Government has intervened. The bankruptcy process is Government intervention.

Senator QUAYLE. Intervention in this instance.

Mr. JENKINS. Yes. I fully support Bruce Johnston's proposal for modernizing bankruptcy. But you will get to that soon after you get a means test on Social Security.

Senator QUAYLE. I am just trying to get the critical answer here, and I am not doing very well, but I understand.

Mr. JOHNSTON. Senator, for my response, the people I am sitting here with are all outstanding at their work; I have known them all a long time. Our differences certainly are not personal, they are institutional, and I have a different view on bankruptcy do's and don'ts for the future.

I think most of the downsizing, still some to be done, but the great share of it has been already taken place. That is number one.

Number two, we would be wrong to leave you with any perception that we need a revitalized industry. We have a very modern, very efficient, very competitive domestic steel industry now in the United States. The strides that have been made by our company and by our competitors in reducing cost, in improving performance, in adding facilities with some of the most imaginative financing anyone could conceive, has been outstanding. We think in our company, we are cost-competitive with any company in any country in the world, with the possible exception of South Korea and Taiwan. And when you consider the social structural differences there, that is a remarkable achievement. We know our competitors have made tremendous strides, and the consumer is going to benefit from that. The taxpayer benefits from that.

We do not see any massive failures coming down the road. Now, there is always the possibility that business risk will do that.

Senator QUAYLE. Yes, there is always a possibility of collapse.

Mr. BARNETTE. May I add, Senator, that we have basic long-term problems, and crisis legislation or a crisis approach to it, most respectfully, I would suggest, is not the way to deal with the fundamental structural long-term problems, and that is the heart of S. 1811, to provide transition, to permit the structural problems to be

worked out over time, recognizing the enormous cyclicality of our business and our markets.

Senator QUAYLE. And that gets back to the question of the preceding panel and what kind of assistance has helped; is the transition rule sufficient, or do you actually have to have the transition rules, plus this legislation; and if you get into this legislation—in my judgment, we have to find some of these outstanding circumstances——

Mr. BARNETTE. We submitted as an exhibit to the statement five points of possible transition legislation of which S. 1811, dealing with restructuring costs, is one of the five, Senator. And I believe the Administration at least addressed some of the other points and seemed to agree with them.

Senator QUAYLE. Thank you.

Senator METZENBAUM. Senator Heinz?

Senator HEINZ. Mr. Johnston, in your testimony, I must say I was surprised by your lack of understanding—at least, apparent lack of understanding, of Federal law, such things as the legislation refers to the cost to the Federal Government, and you disagree that the Pension Benefit Guaranty Corporation incurs a cost to the Federal Government. I have got to tell you it is an on-budget agency——

Mr. JOHNSTON. Of course, it is, Senator, but it gets its funding from companies.

Senator HEINZ. Excuse me, excuse me. I have not finished my statement yet.

When they have a deficit, it makes the Federal budget deficit larger. And I want to try and figure out a couple things about your testimony to see if there are other misunderstandings or misconstructions. Let me——

Mr. JOHNSTON. Can I answer the question?

Senator HEINZ. I have not asked the question yet. Let me ask you this. You make another point which is, if I am correct, that a company should have to continue operating a plan even though they are not making pension contributions, until the company is liquidated.

Now, my question to you is, if I understand your point correctly, how does that help the Pension Benefit Guaranty Corporation to have a pension plan to continue to accrue benefits and spend down its assets before it is turned over to the PBGC? Doesn't that just make the liabilities larger, and aren't you suggesting in effect an approach that is even worse than present law?

Mr. JOHNSTON. Well, I don't think so. I think first of all, what we were saying in our statement—and we think we understand it—is that the PBGC is supported by a head tax on existing pension funds. In our case, that is about $1 million a year. And it gets its major funding from defined benefit pension plans of all the companies that qualify those plans in the United States. So its funding is not primarily from the Government, although the Government has the expense of carrying the agency.

Second, what we were saying is that we do not believe that a company operating in Chapter 11 should be allowed to dump its pensions unless it offers a claim on its assets right then and there to the PBGC on a priority basis. We also do not think that a com-

pany which is underfunded should be allowed to waive its pension contributions and its pension funding.

Senator HEINZ. Well, I understand your testimony in that regard, but that was not the question I asked. The question I asked was you close the Chapter 11 window and the result is that a company has to continue to operate the pension plan until they go into Chapter 7, not 11. As they are wrestling with Chapter 11, the pension plan is making payments. It has not been terminated at that point. Payments are going out of the plan with no contributions going in. And what is going to be left, I fear, is a sucked dry pension plan, but the benefits are still going to be liabilities to the PBGC. And what we all ought to be looking at here is a fiscally responsible solution.

And I am asking you if I understand and you understand the dynamics from the standpoint of what happens to the PBGC, and the consequences to all the other people, first the Federal Government on whose books it rides, and second all the other people out there, including yourself, who have to pony up eventually additional premiums each year.

Mr. JOHNSTON. That is exactly right.

Senator HEINZ. I have got a problem. I have got to go vote. You may want to submit that in writing. I am going to——

Mr. JOHNSTON. I would be glad to offer it orally or in writing, whichever you prefer. But I would sure like to get my answer in, because that is a probative question.

Senator HEINZ. The problem is that I have to go and vote. I think Senator Metzenbaum will be back in about 1 or 2 minutes. So I am just going to ask you to hold on. I am not even going to recess the hearing because that means people will get up. I am just going to leave you in suspense until Senator Metzenbaum returns.

You could complete your answer to him, but I have about minus one minute before I vote, and I apologize to you all.

[Pause.]

[The following response was subsequently submitted for the record:]

SENATE BILL S.1811

This responds to Senator Heinz' questions (Page 80) to Mr. J. Bruce Johnston, USX Corporation, which he was not allowed to answer at the Hearing because the Senator left to attend a roll call vote.

The reason we are opposed to your Bill, (S.1811), Senator, is not because we don't understand it. We are opposed to S.1811 because we understand it all too well.

Senator, you disputed my earlier testimony on who pays for the PBGC by saying, I 'did not understand the PBGC and its cost support system. It's an on-budget item which the government carries.' Senator that is just plain mis-leading. Perhaps you were poorly advised. PBGC is a Self-Financing Agency, and pension payers (companies with Pension Plans) carry not only those pension payments to individuals but also the administrative costs of running the Agency. To keep PBGC self-financing, two reforms need to be made. If inefficient companies go Chapter 11, but nevertheless still want to keep operating facilities for their executives, shareholders, and lenders, then make them fund pensions on a current basis while they operate - currently they have the cash to do so. If they can't pay promised wages and pensions, then equivalent assets should be made available on a priority basis to PBGC immediately. Why should taxpayers carry shareholder pension payments for them when shareholder's assets are available to do so? That's the question - not who funds PBGC.

The billions of dollars involved in supporting steel companies who failed to fund their Pension Plans are paid for by corporate pension plan sponsors on whom ERISA levies head taxes to get the money it then sends to the pensioners of our failed competitors. That's where the enormous sums come from - us - and all the other companies who funded adequately. The Government's share of the cost is zilch - unless this Bill is enacted, then taxpayers will get the cost.

The Federal Budget operates essentially on a cash basis, year by year - a deficit or a surplus - not a long range accrual basis. To date the PBGC, as a matter of fact, has provided a net favorable effect on the Federal Budget, and the rate increases now proposed in various legislation will substantially expand this favorable effect on the Federal Budget for several years even if LTV's unfunded liability remains dumped on the PBGC.

I understand the economics of a Pension Plan and its relationship to its sponsoring company, its participants, its effect on shareholders and debtors of the company, and its relationship to PBGC very clearly Senator. We cannot support bad legislation like S.1811 simply because you and Senator Metzenbaum say you will not support good legislation by fixing an abuse in our Bankruptcy Code. Congress could, in the alternative, easily and simply provide PBGC with a priority claim on a dumping company's assets

when it elects to terminate its Pension Plans. Congress should also require a company to fund its pensions on a priority basis (the same as FICA taxes or unemployment taxes) when that company wants to operate, compete, and build new facilities all the while sheltered and protected by Chapter 11.

Pensions are a voluntary commitment, but once given, the employer should be made to understand that the promising company owes employees that commitment, and will henceforth be required to fund those Pension commitments on the same basis as employee wages and government taxes on those wages. Congress should mandate, plainly and clearly, that Pension funding must be on a current basis. When a company fails to do that, it should then be required immediately to pledge specified assets of equal market value to the PBGC for the shortfall. Failing that, a company should be precluded from paying anything to risk-lenders and shareholders when it is not funding its employee pension promises. Wage and pension promises should be prioritized ahead of risk-taker's rewards.

If these plain, clear, and uncomplicated provisions were legislated, then pension plans could not be --- to use your very words Senator Heinz --- "sucked dry!"

We differ with the Bill's sponsors, Senator, when you say that it is either the present law (without fixing its deficiencies) or your proposed taxpayer bailout of steel executives, shareholders, and their banks. Surely, one Federal Pension Agency is enough. Let's improve the law that was created to deal with this very problem, maintain its basic structure (including the PBGC) but provide a system that will work fairly for all companies.

It's precisely because I do "understand the dynamics from the standpoint of what happens to the PBGC, and the consequences to all the other people...." that we oppose this taxpayer bailout of companies which failed to fund their employee pensions.

Senator, if the overall objective is to make sure employees and retirees involved are reasonably protected, then insist that all companies fund their Plans on a priority basis - no exceptions! When a company cannot pay wages and fund Pension promises, its assets should, then and there, be used to do that job - not preserved for the benefit of creditors, shareholders, and executives who want the rewards, but not the risks of a market economy.

J. Bruce Johnston

Senator METZENBAUM. The hearing will resume.

We are ready for our last panel—Mr. Richard Darman, Managing Director, Shearson Lehman Bros. Mr. Darman, we are happy to hear from you. The Chair had hoped to wind this up by 12 o'clock by reason of another commitment. So if you can confine your remarks to 5, 4, 3 minutes, give us the essence of what you have on your mind. We are very pleased to have you here and thank you for your cooperation.

Mr. DARMAN. Mr. Chairman, could I just ask one question? Do you in fact intend to end by 12 o'clock? If so, I had better make it about 10 seconds.

Senator METZENBAUM. No, we are not going to be able to end by 12 o'clock, but we would like to try to end shortly thereafter.

STATEMENTS OF RICHARD G. DARMAN, MANAGING DIRECTOR, SHEARSON LEHMAN BROS., WASHINGTON, DC; ROBERT W. CRANDALL, SENIOR FELLOW, THE BROOKINGS INSTITUTION, WASHINGTON, DC; EUGENE KEILIN, PARTNER, LAZARD FRERES & CO., NEW YORK, NY; AND JOHN T. LANE, SENIOR VICE PRESIDENT, MORGAN GUARANTY TRUST CO., NEW YORK, NY

Mr. DARMAN. Mr. Chairman, thank you very much.

I would ask that you include the complete statement that I have provided in the record.

Senator METZENBAUM. Each of the witnesses' entire statement will be included in the record.

Mr. DARMAN. Given the limited time, I would summarize as follows.

First, with respect to the economic status of the steel industry, although the performance of the steel sector recently has improved somewhat, the industry continues to face very serious problems and uncertainties. Several companies are in bankruptcy; most have seen their stock prices and stockholders' equity decline. Even with the weaker dollar, foreign competition remains a serious threat, a threat that would increase if the dollar were again to turn upward or if the current VRA were not satisfactorily renegotiated or replaced upon its expiration.

There is in addition the threat of recession in an industry that is especially vulnerable to macro-economic cycles, as well as the continuing threat of technological evolution that may substitute new materials for steel.

Although the steel industry has already engaged in major restructuring, the combination of continuing threats and uncertainties has led many analysts to argue that the industry must undergo further restructuring, and it has led some companies to consider Chapter 11 bankruptcy as a strategic alternative.

The problem is compounded by the fact that the major restructuring of the 1980's has forced steel companies to assume large, unforeseen employee benefit liabilities.

This, along with the factors noted above, has left many steel companies in a highly unsatisfactory credit position. All of the major steel companies have suffered multiple credit rating downgradings during the past ten years. In this period, the year-end ratings of the largest steel companies taken together dropped 27

times, with only one instance in which a year-end credit rating was improved.

Further, the problem of unfunded employee benefit liabilities is a kind of Catch-22. Some companies cannot attract sufficient capital because of the continuing need for restructuring, but rational restructuring is impeded because sufficient capital is not available on satisfactory terms.

With respect to the public policy interest, it seems to me, Mr. Chairman, that America clearly, as you have suggested, has a public policy interest in a healthy United States steel industry. In addition to the conventionally identified interests in support of this proposition, there is a special public policy interest that grows out of the pension liability issues that I have alluded to.

The existence of large unfunded pension liabilities has made bankruptcy a more attractive strategic option. But the increased attractiveness of bankruptcy has several adverse effects on the public interest. It threatens to short-change workers; it threatens to impose steel sector restructuring on less satisfactory terms than might otherwise be achievable; and it threatens to transfer an additional estimated $3.5 billion or more in unfunded pension liabilities to the PBGC.

A word about S. 1811. It is focused on the pension liability problem that I have just discussed, and it might be conceived as a double insurance plan.

First, it intends to assure that workers who are forced to retire as a result of restructuring are able to receive the pension benefits they negotiated and counted on.

Second, it intends to assure that companies needing to finance such benefits are able to do so on satisfactory terms, notwithstanding the various problems and uncertainties facing the steel industry.

In this way, it reduces the probability that companies would choose Chapter 11 bankruptcy as a strategic alternative.

I see the yellow light, Mr. Chairman, so let me jump quickly to a concluding point.

Senator METZENBAUM. Good.

Mr. DARMAN. The financing arrangement called for is complex. I would be happy to discuss it in response to questions, but if I might take 30 seconds to add one point.

Senator METZENBAUM. Please do.

Mr. DARMAN. Based on our analysis, we do believe not only that the financing mechanism can work as intended, but that it could be managed on a basis that might cost the Government little or nothing.

I would be happy to respond to this further in response to questions, but Mr. Whitfield's suggestion that there could be a loss of $5 to $6 billion, I might respectfully suggest, Mr. Chairman, is really very poorly founded. We are talking only about a maximum of $360 million a year plus interest for 10 years in payments that would go out, and he would have to be assuming, to reach a number like that, that the assets received in return were of no value in the end, and that all of the major steel companies went into bankruptcy. So I find that an extraordinary assumption in order to come up with a

number like that, and we have a very different estimate which we would be happy to make available to you and your staff.

Senator METZENBAUM. I think that is a very significant comment you made, particularly in behalf of Shearson Lehman, and we appreciate it.

[The prepared statement of Mr. Darman follows:]

INTRODUCTORY STATEMENT

BEFORE THE SENATE COMMITTEE ON EDUCATION AND LABOR

By

RICHARD G. DARMAN

MANAGING DIRECTOR, SHEARSON LEHMAN BROTHERS INC.

November 20, 1987

Mr. Chairman and distinguished Members of the Committee, thank you for inviting me to appear before you as you consider the merits of S.1811.

Please let me note for the record that Shearson Lehman Brothers has provided investment banking services to several steel companies, and I personally have advised some steel companies on matters related to restructuring, employee benefit liabilities, and pending legislation. However, neither I nor my firm should be construed as representing the views of any steel company or companies. I mention our client relationships only to meet what I take to be proper standards of disclosure. The views which I offer here reflect my own understanding and judgment.

Given limited time, I would summarize as follows:

(1) Economic Status of the Steel Industry. Although the performance of the steel sector recently has improved somewhat, the industry continues to face very serious problems and uncertainties. Several companies are in bankruptcy. Most have seen their stock prices and stockholders' equity decline. (See attachments.) Even with a weaker dollar, foreign competition remains a serious threat--a threat that would increase if the dollar were again to turn upward or if the current VRA were not satisfactorily renegotiated or replaced upon its expiration. There is, in addition, the threat of recession in an industry that is especially vulnerable to macro-economic cycles--as well as the continuing threat of technological evolution that may substitute new materials for steel. Although the steel industry has already engaged in major restructuring, the combination of continuing threats and uncertainties has led many analysts to argue that the industry must undergo further restructuring; and it has led some companies to consider chapter 11 bankruptcy as a strategic alternative.

The problem is compounded by the fact that the major restructuring of the 1980's has forced steel companies to assume large, unforeseen employee benefit liabilities. This--along with the factors noted above--has left many steel companies in a highly unsatisfactory credit position. All of the major steel

companies have sufferred multiple credit rating downgradings during the past ten years. In this period, the year-end ratings of the largest steel companies (taken together) dropped twenty-seven times, with only one instance in which a year-end credit rating was immproved. (See attachment.) Further, the problem of unfunded employee benefit liabilities is a kind of "catch 22": Some companies cannot attract sufficient capital because of the continuing need for restructuring; but rational restructuring is impeded because sufficient capital is not available on satisfactory terms.

(2) The Public Policy Interest. America clearly has a public policy interest in a healthy U.S. steel industry--as is implicitly and explicitly acknowledged in both law and Executive branch agreements. In addition to the conventionally-identified interests, however, there is a special public policy interest that grows out of the pension liability issues alluded to above. The existence of large unfunded pension liabilities has made bankruptcy a more attractive strategic option. But the increased attractiveness of bankruptcy has several adverse effects on the public interest:

- It threatens to short-change workers.

- It threatens to impose steel sector restructuring on less satisfactory terms than might otherwise be achievable.

- And it threatens to transfer an additional estimated $3.6 billion in unfunded pension liabilities to the Pension Benefit Guarantee Corporation. NOTE: Steel pension liabilities have been the major cause (over three-fourths) of PBGC's current financial difficulties. Additional steel bankruptcies would obviously compound the current problem.

The public policy interest would seem to merit a transitional pension benefits financing program for steel that would:

- protect workers' benefits on a basis more favorable than bankruptcy;

- allow the steel industry to restructure rationally without counter-productive restraints or incentives; and

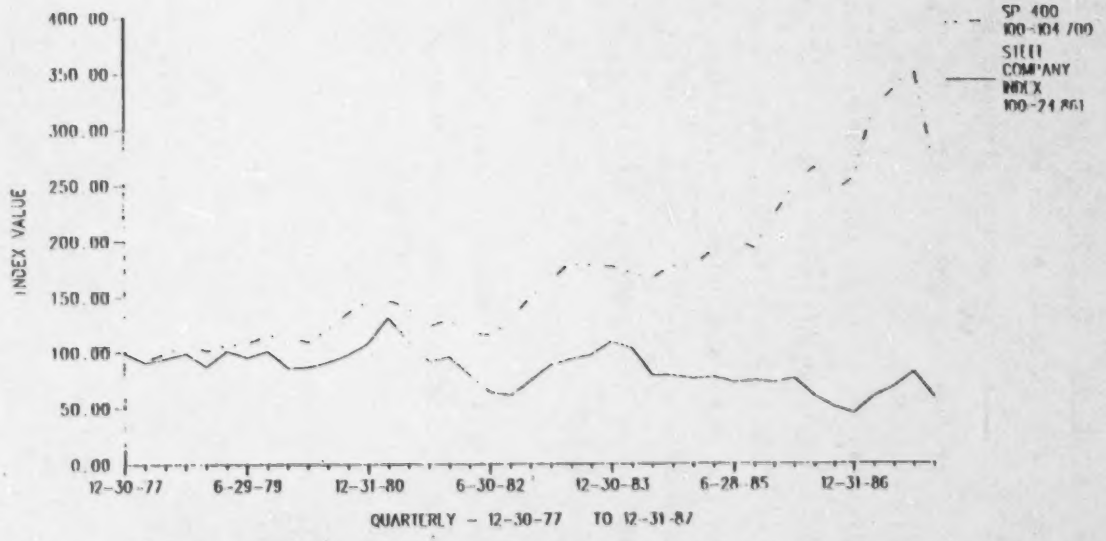
- cost the government less than it might otherwise be likely to pay.

(3) The S.1811 Concept. S.1811 seems to be specifically--and, on the whole, successfully--designed to serve the public policy interests noted above. It is focussed on the pension liability problem--and might be conceived as a double insurance plan: First, it intends to assure that workers who are forced to retire as a result of restructuring are able to receive the pension benefits they negotiated and counted on. And second, it intends to assure that companies needing to finance such benefits are able to do so on satisfactory terms--notwithstanding the various problems and uncertainties facing the steel industry. In this way, it reduces the probability that companies would choose chapter 11 bankruptcy as a strategic alternative. It thereby reduces the adverse effects that might otherwise follow from the existing incentives for the election of bankruptcy or for the postponement of restructuring in the absence of bankruptcy. It meets these objectives through a financing mechanism that relies upon a combination of the government's capacity to guarantee borrowing as a means to attract capital in the near term and participating companies' capacity to improve their economic performance over the longer term. The latter is intended as a basis for compensating both the government and investors for the risks they undertake.

(4) The Operation and Effect of S.1811. The financing arrangement called for by S.1811 is complex. But it appears to be workable in the manner intended. It would serve the double-insurance objectives noted above. It could be managed on a basis that might cost the government little or nothing. It should reduce the chances that the government might have to assume additional large liabilities as a result of steel sector bankruptcies. And although it would not be a panacea for the steel industry, it would constructively address one of the industry's major problems--in a manner that represents what is probably the lowest-expected-cost solution from the perspective of the government.

I shall be happy to respond to your questions with regard to these summary points--and to any other questions.

STEEL COMPANY INDEX
VS.
S&P 400 INDUSTRIALS



STEEL COMPANY INDEX includes: Armco Inc, Bethlehem Steel Corp, Inland Steel Ind, LTV Corp. National Intergroup Inc and USX Corp.

Source Value Investdata

Summary Financial Data on Selected Steel Companies

Company	Year	Book Value	% Change
Armco	78	$1,521	NA
	79	1,664	9.4%
	80	2,015	21.1%
	81	2,440	21.1%
	82	1,955	-19.9%
	83	1,213	-38.0%
	84	924	-23.8%
	85	1,018	10.2%
	86	404	-60.3%
	87	NA	NA
Bethlehem Steel	78	2,360	NA
	79	2,570	8.9%
	80	2,622	2.0%
	81	2,763	5.4%
	82	1,237	-55.2%
	83	1,088	-12.0%
	84	932	-14.3%
	85	786	-15.7%
	86	613	-22.0%
	87	NA	NA
Inland Steel	78	1,230	NA
	79	1,297	5.4%
	80	1,285	-0.9%
	81	1,295	0.8%
	82	1,185	-8.5%
	83	1,118	-5.7%
	84	1,059	-5.3%
	85	870	-17.8%
	86	980	12.6%
	87	NA	NA
LTV	78	254	NA
	79	419	65.0%
	80	799	90.7%
	81	1,277	59.8%
	82	1,108	-13.2%
	83	985	-11.1%
	84	1,211	22.9%
	85	371	-69.4%
	86	(2,836)	-864.4%
	87	NA	NA
National Intergroup	78	1,281	NA
	79	1,343	4.8%
	80	1,414	5.3%
	81	1,444	2.1%
	82	1,492	3.3%
	83	1,007	-32.5%
	84	875	-13.1%
	85	865	-1.1%
	86	912	5.4%
	87	NA	NA
USX	78	5,281	NA
	79	4,895	-7.3%
	80	5,288	8.0%
	81	6,260	18.4%
	82	5,933	-5.2%
	83	4,570	-23 0%
	84	4,862	6.4%
	85	5,405	11.2%
	86	4,734	-12.4%
	87	NA	NA
Wheeling-Pittsburg	78	298	NA
	79	341	14.4%
	80	353	3.5%
	81	411	16.4%
	82	322	-21.7%
	83	247	-23.3%
	84	213	-13.8%
	85	(99)	-146.5%
	86	(360)	NA
	87	NA	NA

Source: Value Line and Standard & Poor's publications.

Summary Financial Data on Selected Steel Companies

Company	Year	S&P Rating	Upgrade/ Downgrade	LT Debt/ Cap.	P/E Ratio
Armco	78	A		26.3%	5
	79	A		23.0%	5
	80	A		19.4%	7
	81	A		19.6%	7
	82	A-	Down	27.6%	Deficit
	83	BBB+	Down	38.5%	Deficit
	84	BBB-	Down	41.8%	Deficit
	85	BB-	Down	36.5%	Deficit
	86	B+	Down	55.4%	Deficit
	87	B+		NA	13
Bethlehem Steel	78	A		29.8%	4
	79	A		28.0%	4
	80	A		27.8%	9
	81	A		26.0%	5
	82	BBB	Down	50.7%	Deficit
	83	BBB		46.3%	Deficit
	84	BB+	Down	52.2%	Deficit
	85	BB-	Down	62.0%	Deficit
	86	B-	Down	64.7%	Deficit
	87	CCC+	Down	NA	15
Inland Steel	78	AA-		31.5%	5
	79	AA-		30.1%	6
	80	A	Down	35.5%	22
	81	A		34.3%	11
	82	BBB	Down	36.9%	Deficit
	83	BBB		40.8%	Deficit
	84	BBB-	Down	41.8%	26
	85	BBB-		48.7%	Deficit
	86	BB	Down	42.6%	58
	87	BB-	Down	NA	17
LTV	78	B		73.8%	4
	79	B		68.4%	2
	80	B		63.2%	4
	81	B-	Down	48.0%	3
	82	BB-	Up	56.7%	Deficit
	83	BB-		57.3%	Deficit
	84	BB-		60.3%	Deficit
	85	B-	Down	74.1%	Deficit
	86	CC	Down	NA	Deficit
	87	D	Down	NA	Deficit
National Intergroup	78	A+		32.0%	5
	79	A+		30.0%	5
	80	A-	Down	28.1%	6
	81	A-		31.9%	7
	82	A-		26.8%	Deficit
	83	BBB-	Down	39.2%	Deficit
	84	BBB-		36.9%	20
	85	BBB-		13.3%	Deficit
	86	BB-	Down	12.5%	Deficit
	87	BB-		NA	Deficit
USX	78	AA-		26.1%	9
	79	AA-		29.3%	Deficit
	80	A	Down	28.6%	4
	81	A		23.8%	3
	82	A		47.5%	Deficit
	83	BBB+	Down	54.5%	Deficit
	84	BBB	Down	48.9%	26
	85	BBB		44.1%	16
	86	BBB-	Down	50.1%	Deficit
	87	BB+	Down	NA	Deficit
Wheeling-Pittsburg	78	CCC		33.7%	3
	79	CCC		28.6%	2
	80	CCC		39.0%	7
	81	CCC		41.6%	4
	82	CCC		51.2%	Deficit
	83	CCC		56.5%	Deficit
	84	CCC		59.3%	Deficit
	85	D	Down	NA	Deficit
	86	D		NA	Deficit
	87	U	Down	NA	Deficit

Source: Value Line and Standard & Poor's publications.

Senator METZENBAUM. The next witness is Robert Crandall, Senior Fellow of The Brookings Institute.

Mr. CRANDALL. Thank you, Mr. Chairman.

I appear here as a steel economist, who has looked at this industry for 10 years or more now. What I always find surprising about hearings on the steel industry is that only a part of the steel industry seems to appear at these gatherings.

The steel industry is undergoing an enormous transformation, as you know. What is happening is that new, competitive, dynamic companies are replacing tired old integrated companies. It is only the latter who have appeared before you this morning to discuss this proposal. We do not hear from the likes of Nucor, North Star, Chaparral, Raritan River. All of these are new, expanding steel companies. These companies collectively have taken a larger market share away from the integrated companies and forced more shutdowns than imports have in the last ten years.

Senator METZENBAUM. What percentage of the production today do all of those companies together comprise?

Mr. CRANDALL. They account for about 20 percent, up from about 3 or 4 percent 10 or 15 years ago. Imports today are running around 5 million tons above what they were 10 years ago; mini-mill shipments are running perhaps 8 million to 10 million tons above what they were 10 years ago.

During this last 10-year period, there have been considerable difficulties in the steel industry despite the fact that the industry has received substantial help from the Government—help in the form of substantial trade protection, the refunding of investment tax credits, and of course, huge subsidies of their pension liabilities through the Pension Benefit Guaranty Corporation.

The bill we are discussing this morning is designed to take some of the pressure off the Pension Benefit Guaranty Corporation and to facilitate restructuring in the industry. I would suggest to you that the costs of the PBGC have already been borne, that is, subsidies have been paid; they have been a given in the collective bargaining arrangements of the steel industry over the past 13 years since ERISA was passed, and the union and the companies have adjusted to them.

The question now only is how much the Government will eventually have to pay and whether there is any way to minimize this without even greater costs upon U.S. taxpayers.

I would submit to you that the proposal today, which might be deemed a form of industrial policy, given the discussion of the last 5 years, is the type of proposal which confers benefits only upon companies which are the least likely to provide future productive capacity to the U.S. steel industry.

One has to keep in mind that 10 years ago, there were 17 integrated steel companies in the United States that I could identify. Eleven of them have now either passed into Chapter 11 or disappeared completely. This legislation would apply only to a subset of those, those who have had plant closing costs, and these companies, if in fact they use this money to restructure, are likely to use it very ineffectively.

The integrated steel companies that have modernized the most—I am thinking of Republic, CF&I, Wheeling-Pittsburgh, Sharon, and

Kaiser, over the late 1970's into the early 1980's—are those which are either history or in Chapter 11 today. And the reason is that it is impossible for many of those companies to modernize old facilities economically, given the cost of modernization.

So, I find this bill unfortunately without any merit, because I do not believe that it provides resources to the right organizations within the steel industry. I do not know that those who are succeeding today need any resources from the Government, and I would not advocate that.

However, I do think that this is a counter-productive proposal, one which is almost sure to result in further demands on social savings. I find it ironic that we are discussing this today, the deadline for Gramm-Rudman, sequestration, a process which is being driven by a concern that the Federal deficit is making an enormous call upon our very limited social savings, and now we are proposing by this legislation to make an even further call on social savings for what essentially are nonproductive purposes.

Thank you.

Senator METZENBAUM. Do I understand the bottom line of your testimony, Mr. Crandall, that you would let those steel companies that cannot cut it just go down the drain?

Mr. CRANDALL. I think it is inevitable that there will be further cutbacks in the integrated industry. I think that when you do these sorts of things, you simply embolden the unions to ask for greater wages and greater pension benefits, as of course is happening now with LTV.

I do not believe that the total amount of productive facilities in the steel industry that remain has anything to do with the identity of the players. The facilities of the integrated firms which will survive, which are economic, will survive after Chapter 11, after Chapter 7, regardless of what you do up here.

Senator METZENBAUM. Does that mean your answer is yes?

Mr. CRANDALL. I would certainly not think that it is the role of the U.S. Congress to attempt to subsidize the losers to keep them from failing if in fact economics dictate that they must fail, yes.

Senator METZENBAUM. So therefore, the answer is yes?

Mr. CRANDALL. I would—yes, absolutely.

Senator METZENBAUM. OK.

Mr. Eugene Keilin, partner, Lazard Freres. We are happy to have you with us, sir.

Mr. KEILIN. Thank you, Mr. Chairman.

I dissent from the conclusions of the previous speaker. I was the investment banker who helped organize the Weirton Steel Co., which is the largest and the first employee-owned company in the steel industry. And you can understand if I believe that steel capacity, that other people have given up on, can in fact be restructured and saved and become an important producer of quality steel and an important part of the economy.

This bill is specifically about the pension problem, but it is really about the problems of the steel industry, as most of the witnesses today have said.

I would like to make three points briefly about the industry. First, that its financial condition is precarious and that its financial options are limited. It has suffered years of unremitting losses,

relieved only by very modest operating profits in the last 12 months. It is certain to face losses in the future; it is heavily leveraged. In the past five years in order to produce cash to keep the doors open, it has used up most of the options which it has as an industry.

You know most of those facts. You may not know that the cost of unfunded pension and other retiree liabilities is significantly in excess of the remaining net worth of the entire domestic steel industry if in fact the book value is anything like an accurate reflection of its economic value.

Financial markets are skeptical, even hostile. In the simplest terms, if you want a steel industry in anything like its present form, doing nothing is not an option. Senator Quayle asked the preceding panel if they believed that bankruptcies were inevitable. None of the speakers wanted to acknowledge that his company was a candidate for bankruptcy, but the simple fact is that unless something significant is done in the industry, there are likely to be subsequent and substantial bankruptcies. It is a classic case of pay now or pay later.

Second, despite the problems in the industry in recent years, considerable progress has already been made toward restructuring and reform. You know about the jobs that have been lost, the capacity that has been shut down. You may not know that even in the worst of the steel depression, capital expenditures in the industry have exceeded the depreciation as the industry has tried to continue to find the cash to modernize and compete on a worldwide basis. But obviously much more remains to be done, and that leads to my third point, which is the legislation under discussion today could provide a catalyst or a process for further progress in the industry. It would provide capital on terms which are otherwise unavailable to the industry. That would permit flexibility on the part of many companies not simply to keep alive inefficient or obsolete capacity, but to continue the process of restructuring and of modernizing.

Since the companies would be required to exchange assets of real value for the assistance they receive, and since presumably under appropriate rules, the authority would see that they got value for the assistance, this is not a program that should be a problem for other companies that do not need the assistance. In effect, it will be purchased by the participating companies.

I would say in that connection that there are elements of the bill which need to be investigated further. One of them that I would mention specifically is my own view that in exchange for any assistance that is provided under the bill, the companies involved should submit business plans that will indicate how the assets which they exchange will have value and how they will continue the process of restructuring themselves and of getting contributions from the other parties so that they can in fact be profitable and sustain themselves over the long term.

Thank you very much.

Senator METZENBAUM. I think that is a good suggestion, and I think we can include that in the bill. Let me ask you a question. Do you think that there is a reasonable possibility or probability, whichever the case, that if we enact this legislation and if the Federal Government provides a guarantee which is contemplated in

the bill, that the matter can be operable and the Federal Government not wind up bearing any of the financial burden?

Mr. KEILIN. The answer to that is yes, Mr. Chairman. I think the history of Federal guarantees is actually quite good. In that regard, I was involved in the New York City financial problems of 10 years or so ago, where Federal guarantees wound up not costing the Federal Government anything, but were the catalyst for the city's reform.

I think properly structured, a program of this kind could provide reasonable assurance that it would not wind up costing the Treasury or the taxpayers anything.

Senator METZENBAUM. Would your answer be the same, Mr. Darman?

Mr. DARMAN. Yes, it would, Senator Metzenbaum.

Senator METZENBAUM. Thank you.

Our last witness is Mr. John Lane, senior vice president, Morgan Guaranty Trust Co., New York, NY. We are happy to hear from you, sir.

Mr. LANE. Thank you, Mr. Chairman and members of the Subcommittee.

I have submitted a statement, but in the interest of time I will try to condense it.

The first point is I want to echo what has been said by others. The United States steel industry has, through the joint effort of labor, management and capital, improved its global competitive position. Labor has accepted changes in work rules and the closing of clearly uneconomic facilities. Management has improved its efficiency by eliminating excess layers and procedures and providing sharper focus on quality and operating efficiency.

The financial sector, including shareholders, has invested almost $8 billion in new capital in the industry over the last several years.

Despite the above effort, which has produced improved financial performance, the United States steel industry continues to face very severe problems caused by global excess capacity, which has been dwelt upon at length here; declining secular trends; and financial liabilities related to its health care and pension obligations. The size of these financial obligations is staggering in relation to assets employed and industry earnings, particularly if one has any concern about a possible economic downturn over the next few years.

Consider the following: Two of the major integrated steel producers are in Chapter 11; none of the integrated steel corporations have investment grade credit ratings; only one major steel firm in 1987 was able to borrow significant amounts of new funds from the banking community on anything except a fully secured basis, some of the firms in the industry still have difficulty obtaining letters of credit to support normal business obligations even—even—on a cash-collateralized basis.

All of these facts point to the difficulty the industry faces in raising new capital necessary to continue the modernization process essential to be competitive on a global basis.

Given the Nation's commitment to an open economy, failure to be globally competitive can only lead to the eventual demise of the industry. Import quotas for the steel industry are not a long-term

solution. What America needs is the opportunity to be the least cost and highest quality producer in the world.

I believe the proposed Steel Retirement Benefit Funding Act provides a method for dealing with one of many pension issues which hang like millstones around the neck of the industry.

Although I have some concern about the scope and nature of the participating companies' liabilities should a termination then occur under this legislation, the basic concept is constructive. It is in marked contrast to the approach of imposing super priority liens to cover pension liabilities, which is now pending in the budget reconciliation legislation.

The super priority concept is of great concern to the financial community and if pursued, may very likely restrict the access to capital by all industries with significant labor forces where there is any concern over a dramatic downsizing, as has occurred in the steel industry. This would be true even if S. 1811 is passed.

While many people agree that the goals of the bill are excellent, there are some who are concerned about the execution feasibility of the asset trade for liability assumption, which is the key operative feature. There is understandably concern in some quarters that the Federal Government might not receive fair value for the liabilities assumed and thus both the general public and perhaps certain competitors within the steel industry could be disadvantaged.

The traditional way for insuring the fairness of such trades would be independent options from experts that a swap was indeed fair. Given the subjectivity of many possible factors in these exchanges, the issue is a very serious one. However, given the openness with which the U.S. governmental process works today, I would expect that the interest of the general public will be protected on the exchange issue not only by expert testimony and opinion, but also by the close scrutiny that I am sure that various competitors in the industry will give each exchange to insure that their relative position has not been unfairly eroded.

In summary, I believe the proposed Steel Retirement Benefit Funding Act is a constructive proposal and should be approved.

[The prepared statement of Mr. Lane follows:]

November 20, 1987

Hearing on the Steel Retirement Benefits Funding Act of 1987

Statement of John T. Lane
Senior Vice President
J.P. Morgan & Co.
New York, New York 10015

(212) 483-3328

November 20, 1987
Hearing on the Steel Retirement Benefits Funding Act of 1987
Statement of John T. Lane

Mr. Chairman and members of the subcommittee:

On behalf of J.P. Morgan & Co., I am very pleased to have this opportunity to appear before you this morning.

In preparing my testimony regarding the Steel Retirement Benefits Funding Act of 1987, I have tried to consider several operative factors:

1. My belief that the marketplace is the best allocator of scarce resources within our economy.
2. Concern for the benefits of 215,000 individuals terminated in the steel industry in recent years.
3. Concern for the welfare and future employment of the 170,000 people still working to make the U.S. steel industry globally competitive.
4. Concern for the ripple effect on communities and corporations related to the steel industry downsizing.
5. Concern for the strategic implications associated with a failure to have a strong domestic steel industry.
6. Concern for the equity of this and related legislation to all players.

In the past, the Congress has seen fit to establish a framework for dealing with the problems of financially ailing corporations. The bankruptcy process works well when the issues to be resolved relate primarily to one company. However, we don't have effective legislation for dealing with industry-wide problems.

The U.S. steel industry has through the joint effort of labor, management, and capital improved the global competitive position of the industry. Labor has accepted changes in work rules and the closing of clearly uneconomic facilities; management has improved its efficiency by eliminating excess layers and procedures and providing sharper focus on quality and operating efficiencies; the financial sector including shareholders has invested almost $8 billion in new capital in the industry over the last several years.

Despite the above effort which has produced improved financial performance, the U.S. steel industry continues to face very severe problems caused by global excess capacity, declining secular trends and financial liabilities related to its health care and pension obligations. The size of these financial obligations is staggering in relation to assets employed and industry earnings particularly if one has any concern about a possible economic downturn over the next few years.

Consider the following: two of the major integrated steel producers are in Chapter 11; none of the integrated steel corporations have investment grade credit ratings; only one major steel firm in 1987 was able to borrow significant amounts of new funds from the banking community on anything except a fully secured basis; some firms in the industry still have difficulty obtaining letters of credit to support normal business

obligations even on a cash collateralized basis. All of these facts point to the difficulty the industry faces in raising new capital necessary to continue the modernization process essential for the industry to be competitive on a global basis.

Given the nation's commitment to an open economy a failure to be globally competitive can only lead to the eventual demise of the industry. Import quotas for the steel industry are not a long term solution. What America needs is an industry capable of producing the highest quality steel at the lowest possible price. Attaining this goal and maintaining this position is only possible through access to capital and the continuation of the constructive efforts that labor and management have initiated in the last few years.

I believe the proposed Steel Retirement Benefits Funding Act of 1987 provides a method for dealing with one of many pension issues which hang like mill stones around the neck of the industry. Although I do have some concerns about the scope and nature of the participating companies' liabilities should a termination event occur under this legislation, the basic concept is constructive. It is in marked contrast to the approach of imposing super priority liens to cover pension liabilities which is now pending in the budget reconciliation legislation. The super priority concept is of great concern to the financial community and if pursued may very likely restrict the access to capital by all industries with significant labor forces where there is any concern over a dramatic downsizing as has occurred in the steel industry and this would be true even if the S1811 legislation is passed.

While many would agree that the goals of the bill are excellent, there are some who are concerned over the execution feasibility of the asset trade for liability assumption, which is the key operative feature of the program. There is, understandably, concern in some quarters that the government might not receive fair value for the liabilities assumed and thus both the general public and perhaps certain competitors within the steel industry could be disadvantaged.

The traditional way for insuring the fairness of such trades would be independent opinions from experts that a swap was indeed fair. Given the subjectivity of many possible factors in these exchanges, the issue is a very serious one. However, given the openness with which the U.S. governmental process works today, I would expect that the interest of the general public will be protected on the exchange issue, not only by expert testimony and opinion, but also by the close scrutiny that I am sure various competitors in the industry will give each exchange to insure that their relative position has not been unfairly eroded.

In summary, I believe the proposed Steel Retirement Benefit Funding Act of 1987 begins to address in a constructive way an industry problem of great concern to many sectors of America. If left unresolved, the shut down pension liabilities will likely remain a specter clouding the future of all of the industry players, their associated communities, and the PBGC for years to come.

Senator METZENBAUM. You heard me ask the question of Mr. Keilin and Mr. Darman as to whether or not there was a reasonable possibility or probability that the Federal Treasury would not be negatively impacted if this legislation is enacted. Their answer was that they did not think it would be.

Do you have an opinion?

Mr. LANE. The objective of the bill is to help the steel industry be competitive. If it is competitive, there should be no cost to the Treasury.

Senator METZENBAUM. All right. Let me ask you, Mr. Darman, what are the implications to the steel industry of the Finance and Ways and Means proposals to prevent companies from terminating provision plans except in Chapter 7 and to have liens automatically arise in favor of the PBGC when a pension plan is underfunded?

Mr. DARMAN. Mr. Chairman, Mr. Lane has spoken to that to some degree in his testimony and may wish to comment further, but I would say with respect to some companies it would in fact cause an event of default under their existing financial agreements. There is a more basic philosophical question that I am sure you would wish to address in your capacity in the Judiciary Committee, having to do with what priority one set of claimants might have relative to others, and this is obviously a major shift in the philosophy underlying bankruptcy.

So for those reasons and others that I know you are well familiar with that are discussed in the bankruptcy context, it seems to me this is probably quite undesirable.

Senator METZENBAUM. Would you agree, Mr. Keilin?

Mr. KEILIN. I think, Mr. Chairman, that the provision as I understand it would produce considerable difficulties for obtaining additional capital not just in the steel industry but in a variety of the industries in similar circumstances. And like Mr. Darman, I think it makes a very profound change in effect in the middle of the game in the rules of bankruptcy as a philosophical as well as a practical matter and should be looked at from that point of view.

Senator METZENBAUM. Do you have an opinion on that subject, Mr. Crandall?

Mr. CRANDALL. No, not on the specific way in which the financial arrangement——

Senator METZENBAUM. Mr. Lane, do you have an opinion on the subject?

Mr. LANE. I stated that we have great concern about the legislation, because it will restrict access to capital not only from the financial community but also from suppliers. When difficulty comes, it is the suppliers who are often the ultimate trigger.

Senator METZENBAUM. Thank you very much.

The Chair had a previous commitment for which he is now 20 minutes late. But Senator Heinz has very graciously indicated he was prepared to continue on. I know he has some questions, and as the principal sponsor of the bill, I am going to ask you, Senator Heinz, if you will continue on with such questions as you have.

Senator HEINZ. Mr. Chairman, I thank you. I would be very pleased to.

Senator METZENBAUM. Thank you very much.

Senator HEINZ. Gentlemen, I thank you for your testimony.

As you probably heard when the Administration was testifying, they were suggesting that profits are back for good in the steel industry and that pension liabilities can be eliminated, as the Chairman was just referring to, by passing tough funding standards with a lesser funding requirement for steel plans.

First, would anybody like to provide your prognosis for 1988 in the steel industry? Are we going to see the same level of profits, do you think, as this year? Does anybody want to take a crack at that?

Mr. Darman, Mr. Lane.

Mr. DARMAN. I don't have a specific forecast for the steel industry but it seems to me that one ought at least to look at these considerations. First, the current profit numbers involve, upon examination, a number of extraordinary items, not least of them the investment tax credit provisions of the 1986 Tax Act, which has a favorable effect on the reported earnings of many of the companies. And so the underlying rate of profitability on what one might consider a steady state basis is not as favorable as it would appear.

Two—and this is one of the reasons I cannot offer a forecast—there is an enormous uncertainty inherent in the current questions about our own economy. If you could give me a more reliable estimate than I think most macro economists can about the state of the economy, I could be more confident of my own prediction. But the steel sector is particularly vulnerable to recession.

Senator HEINZ. Mr. Crandall, are you a macro economist?

Mr. CRANDALL. No. I am not sure there is such a thing anymore, Senator.

Senator HEINZ. Do you want to take a crack at a general economic forecast?

Mr. CRANDALL. Well, it is quite clear this is a cyclically sensitive industry, and if the economy does start to weaken next year as a result of the effects of recent financial turmoil, that this industry would be disproportionately affected.

Offsetting that, however, is the continued effect of the depreciation of the dollar. What we have seen is a lagged effect of depreciation of the dollar raising domestic steel prices because import prices have been rising. I think that trend will continue. So there is some offset there, but I think there is no doubt that if and when the economy turns into recession, as surely it will some time in the future, this industry and the integrated producers particularly will be in some difficulty.

Senator HEINZ. S. 1811 creates a convertible fund consisting of steel industry equity and obligations of the Steel Retirement Benefits Authority that is sold to the public to raise money to pay the benefits. What is your view of how this fund would operate, and how marketable do you think it would be?

Mr. Darman?

Mr. DARMAN. I think it would be highly marketable because of the Government guarantee. The exact terms under which it would be marketable would remain to be calculated after one saw the product of the negotiations between the Authority and the companies.

Senator Heinz, I might mention again, because you were not here earlier when I alluded to this, we do have a rather simple computer model of the way in which we understand this fund

would work, and it allows you to make different assumptions about the terms on which agreements would be concluded with the steel companies, how many of them might choose debt—you can vary that; you can vary the rate of interest; you can vary the equity contribution, terms thereof, and so on—and explore with different assumptions what the rates of return might be and what the break-even points are.

I offered, again, to make that available to staff for their own examination. But our conclusion is not only that the fund is marketable, but that one does not need a very high rate of increase in the stock prices, roughly 6 percent, assuming half the companies contributed stock, in order for the Government to come out ahead.

Senator HEINZ. Does anybody disagree with that analysis? Mr. Lane, Mr. Crandall, Mr. Keilin?

Mr. KEILIN. Senator, I would add to it that the mechanism of the authority presents an interesting possible way for the authority and the steel companies to negotiate with their existing creditors and shareholders in effect to get contributions from them to the kinds of plans of reform and restructuring that really have to be developed. The nature of the securities not only has an impact on the ultimate payback to the Government, potentially the marketability of the Authority's securities, but it also has an impact on the interest of existing creditors and shareholders of these companies. And while in the long run that impact should be positive if the companies are stronger and stabilize themselves, in the short term they may be asked to make some contributions of their own to these plans.

Mr. CRANDALL. I just have one response, and that is that I have heard my colleagues on this panel tell me that there is a strong probability or possibility that this bill would not engender any future liabilities on the part of the Government, any future payments out of the Federal budget in order to try to support these instruments; yet they also tell me that the steel industry's debt instruments are below investment grade quality.

If in fact these instruments are marketable, they are marketable because there is a draw on the Federal Government, and I wonder how they can reconcile a prediction that this may result in very little liability to the Government. Is it that the rest of the financial markets are irrational and do not understand that there is not much risk here?

Senator HEINZ. Well, let me ask you a question about that. If this legislation were enacted, wouldn't it improve the financial standing of the companies?

Mr. CRANDALL. Yes, but only because of the Federal Government guarantee; yes, absolutely.

Senator HEINZ. Did you have a comment, Mr. Lane?

Mr. LANE. I think Mr. Crandall's comments don't adequately consider two issues related to the upside potential for the U.S. Government from the legislation. To me the key framework underlying this legislation is a joint union and management (with some exceptions) effort to constructively deal with problems related to downsizing the industry. This legislation addresses the significant human element, involved in the downsizing process. To the extent this legislation reduces the perceived human costs, the difficult ne-

gotiations related to achieving the optimal operating rates for the industry should be facilitated and the Government may benefit substantially from lower social costs and strategic costs related to improved industry performance.

The second issue relates to the upside potential in the financial market for steel securities. Several people today have quite rightly pointed out that the market for these securities is at a very low point today, consequently there may well be considerable upside potential for securities taken by the Government in liability exchanges, if the industry operating rates improve.

Mr. DARMAN. Senator Heinz, could I add one point, if I might?

Senator HEINZ. Mr. Darman.

Mr. DARMAN. The further point that many have alluded to and that I understand to be a premise of your legislative approach: This reduces the probability that companies would elect Chapter 11 as a strategic alternative. And the combination of the better financing terms and the insurance of the capacity for future financing, notwithstanding all of the uncertainties in this environment, allow the companies to move forward in restructuring on a basis that is likelier to make them healthy than in the absence of this legislation. That is what accounts for the difference.

Senator HEINZ. Let me ask one final question. Earlier in the first panel, USX testified that the financing mechanism in this legislation would not enable them to get capital at lower cost than they can now. First, do you agree that that is true, and would it not in fact be advantageous for them to exchange debt that they are now carrying at market rates for capital raised through this program?

Mr. Darman, you have probably spent more time studying these questions than anybody else. Do you have an opinion on that?

Mr. DARMAN. Yes, Senator, I do. First of all, the way I read the legislation, USX would be a potential beneficiary, and I found it somewhat internally inconsistent in their testimony, the prepared testimony that they provided, that on the one hand, they were arguing that there is this improper subsidy, and then on the other, implicitly, that there was not a subsidy at all. That was one, I may say, of what I thought were many internal inconsistencies in the written testimony provided.

But I am reminded, if I might just mention this, and it is perhaps unfair since USX is not here to respond, but I am reminded of what I recall was the USX position with respect to tax reform, which was, as you may recall as well as I, the total opposition to tax reform and at certain stages, opposition to the investment tax credit treatment that they were ultimately to be a beneficiary of, and then at a much later stage in the process, they received the benefit and to the best of my knowledge did not return the check.

I would not be surprised to find in this situation that if the legislation goes through, they will at some point conclude that yes indeed there is something in this for them, and that they would like to benefit and once again would not refuse the opportunity to benefit.

Senator HEINZ. Is it possible they are opposing something that would be good for their stockholders?

Mr. DARMAN. That they would be opposing something——

Senator HEINZ. That their testimony today represents opposition to an approach that would be beneficial to their stockholders.

Mr. DARMAN. I feel sure that they are representing what they take to be the best interests of their stockholders, so it would have to be a difference of judgment about what might be best for their stockholders.

I personally think that a good case can be made, as many have tried to suggest, that in the absence of this legislation, there will be strategic election of bankruptcy which will adversely affect the whole industry, including USX stockholders, relative to the alternative of having this legislation.

But I assume that there is a basic difference of judgment on that issue. I do not question their motivation.

Senator HEINZ. Mr. Crandall?

Mr. CRANDALL. I think there is a major difference between USX and all the other firms that appeared before you this morning, and that is that USX is the only company that is not a steel company; it is an oil and gas company. It is 70 percent oil and gas. And if they have to pledge securities which draw on their oil and gas returns, then of course they are not in the same position as these other companies which are largely undiversified.

My guess is—and I have not really looked at this carefully—that proposals such as this would provide an additional incentive for them to spin off their steel subsidiary from the rest of the company so as not to hold those other assets hostage to this plan.

Senator HEINZ. What about the other aspect, which is if they elect not to do that, since they do have considerable financial staying power in their oil and gas interests, Chapter 11 or Chapter 7 are clearly not options for them and that since Chapter 11 is an option currently for those other steel companies, they could be put at a very substantial cost disadvantage in the same way as they were with LTV Steel. LTV, by virtue of spinning off its liabilities for pensions to the PBGC and undertaking the shedding of its obligations through the Chapter 11 process, has lowered its costs, it has been testified to, $70, $75 a ton. Why would it not be quite disadvantageous to USX Steel operations and ultimately USX if the rest of the industry proceeded down that path?

Mr. CRANDALL. Well, I am sure they are at least mildly ambivalent for the following reasons. On the one hand——

Senator HEINZ. Mildly ambivalent about what?

Mr. CRANDALL. About support or opposition to this on the following grounds——

Senator HEINZ. No. I just meant in the hypothetical that I posed to you, would it not be the case that they would be disadvantaged or not?

Mr. CRANDALL. Well, they may be disadvantaged by the ability of other companies to shed pension liabilities and to renegotiate labor and raw materials contracts, which is the principal way in which these cost savings are realized, though the cost savings at the margin are nothing like $70 or $75 a ton.

On the other hand, they do not like to see the Federal Government bestowing fairly large subsidies upon their competitors to allow them to reinvest in facilities, at least which for the time

being, though not for the long run, are likely to be competitive with them.

Senator HEINZ. Did you have another point that you wanted to make there?

Mr. CRANDALL. No.

Mr. KEILIN. Senator, it seems to me that the USX strategy has been to be a large fish in a smaller pond and that it has been happy as a competitive matter to see situations where the competition disappears. Therefore, it has to oppose efforts whose purpose seems to be to maintain existing capacity in whatever form they take. This is one such effort. In a sense, bankruptcy is another. They are probably opposed in one form or another to their competition staying in business, as I thought Mr. Johnston frankly acknowledged.

Senator HEINZ. Very well. Well, if there are no further comments—Mr. Darman?

Mr. DARMAN. Senator Heinz, I just wanted to add, if I could, one point. Mr. Crandall used the phrase "large subsidies" for their competitors with respect to USX. It seems to me that phrase is not really appropriate from USX's perspective if I heard their testimony correctly.

As I understood the testimony, when Senator Quayle asked USX if there would be further bankruptcies, they basically said that they thought that there did not have to be substantial further restructuring and that it was not likely that there would be further bankruptcies.

I take it from the way in which they testified that they are assuming a relatively healthy steel industry, with modest further restructuring. If that is the case, I don't know where the large subsidy would arise, because the assets to be provided are of roughly equal value to the liabilities assumed by the Government, and with a healthy industry, the value of those assets rises; it does not fall. And the only subsidy involved is the spread in the financing in the short term, and what is uncertain is how much that is offset by a gain in the future.

So the USX line of analysis really is not consistent with the notion of a large subsidy. I could see other analyses that would argue that way, but not the USX analysis.

Mr. CRANDALL. Senator, I'll bet that when Mr. Darman was at Treasury, he would have called this a subsidy.

Senator HEINZ. Well, Mr. Crandall, let me ask you as long as you bring that up, did you believe the Chrysler program was going to gain money for the Federal Government?

Mr. CRANDALL. I think overall such programs do not in fact result in an improvement in the way resources are allocated in the United States. Whether the Government came out whole on that one or not has to be offset with the way resources have been squandered elsewhere.

You may recall the EDA loan guarantees to steel companies. How many of them came out whole?

Senator HEINZ. Well, I am not clear on your answer to my question. Did you express an opinion or have an opinion at the time of the Chrysler loan guarantee that it would lose or make money for the Federal Government?

Mr. CRANDALL. I don't think I expressed an opinion but at the time it was granted, I did not know we were going to put quotas on Japanese exports of automobiles. Had I known that, I would have said it was fine.

Senator HEINZ. But at the time your conclusion, even though unexpressed publicly, was it was probably a money loser?

Mr. CRANDALL. I would have been opposed to doing it, I am sure, yes, absolutely.

Senator HEINZ. Well, I voted against it, too. It turns out we were both wrong.

Mr. CRANDALL. Well, because of the quotas. Had we not generated much higher car prices for U.S. consumers because of a limitation of 1.68 to 1.85 million exports from Japan, that would not have happened, I am quite confident.

Senator HEINZ. Mr. Darman—point of personal privilege.

Mr. DARMAN. Well, I happen to be a trustee of The Brookings Institution, and I am delighted [laughter]. I am delighted Mr. Crandall is associated with the institution because it does need a little more market orientation. But——

Mr. CRANDALL. It is too bad bankers do not have it.

Mr. DARMAN [continuing]. But while I welcome all of this talk about the virtue of market-oriented policies, I do think it is useful from time to time to remind ourselves of the real world we live in. And this particular world we live in with respect to the steel sector is not at the moment a pure market-oriented system, and it is not fundamentally going to change in the near term. And we do not really have the alternative available, practically, of a totally market-oriented system for steel in the near term, and we do have the PBGC, and I do not think it is going to be undone in the near term in terms of its obligations. So the Federal Government is sitting in a position where it has to ask itself does it want to run the risk of more companies choosing bankruptcy as a strategic option in a situation where already existing law that intervenes in the market would assure that the Government would have to pick up a substantial tab, or, is there an alternative which has a higher probability of avoiding such bankruptcies and producing lower net cost to the Government.

So that is a round-about way of saying, although this isn't necessarily credible, that I suspect that if I were still at Treasury, I would say exactly what I just said.

Senator HEINZ. It also answers a question that Senator Quayle posed. Senator Quayle was expressing some reservations about this legislation because he felt that any proposal should target assistance only to those people in need. And of course, that is exactly what the combination of Chapter 11 and PBGC bailout of pension plans does; and it does such a good job that that is the reason we are sitting here today, talking about this legislation.

The present system makes no sense. The present system is the worst form of industrial policy. It generously rewards losers. And what our approach does is to insist that the people who would otherwise be generously rewarded losers take personal financial responsibility for any assistance. That is why we insist that they fully step up and put their securities into the authority.

[Additional material submitted for the record follows:]

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Salomon Brothers Inc

E. Stephen Benson

November 23, 1987

Senator Howard M. Metzenbaum
Chairman, Subcommittee on Labor
United States Senate Committee on
Labor and Human Resources
Washington, DC 20510-6300

Dear Senator Metzenbaum:

Thank you for inviting me to testify on the Steel Retirement Benefits Funding Act of 1987 ("the Act") before the Subcommittee on Labor last Friday. Unfortunately, I was unable to attend the meeting, but would like to submit this written testimony for the record.

It should be noted that Salomon Brothers Inc has provided investment banking services to several steel companies including Bethlehem Steel, Armco, USX and National Steel, and I have been personally involved in some of these matters. In addition, Salomon Brothers is actively involved in providing research coverage on companies in the steel industry and is therefore knowledgeable of the industry. The views I express herein, however, should not be construed as representing the views of any steel company but our own independent conclusions.

We recognize that the federal government, through the Pension Benefit Guaranty Corporation ("PBGC"), is already facing over $3 billion in assumed pension obligations related to steel industry bankruptcies. In light of this, we commend the concept embodied in the Act as recently introduced by you and Senators Heinz, Durenburger, Riegle, Simon and Specter. This legislation addresses some of the significant financial problems confronting America's pension guarantee system which is inextricably connected with the problems facing our steel industry.

Salomon Brothers Inc

Our steel industry has suffered greatly in the recent past, as evidenced by the fact that more than 20% of industry capacity is now in bankruptcy. Many factors have contributed to the problem including excess worldwide capacity, high levels of imported steel and imported products made of steel (such as automobiles) and the subsidization of foreign steel producers by their federal governments. The steel industry has reduced the number of its employees by 67% from approximately 500,000 in 1974 to 170,000 today. The industry's contraction has resulted in a ratio of two retirees for each active employee. Because of this imbalance, it is imperative that appropriate legislation be implemented. Without remedial action, both the steel industry and the PBGC will be strangled by the $6 billion in existing pension obligations.

The proposed legislation will enable troubled steel companies having limited or no ability to access the capital markets to finance certain of their pension obligations through a government assisted program. This program will allow steel companies to address their pension obligations without seeking recourse to bankruptcy. We believe bankruptcy is an anathema to all concerned parties including: steel companies, employees, creditors, competitors, and federal and local governments alike. This legislation offers an attractive alternative to companies who might otherwise file for Chapter 11 protection and transfer their obligations to an already burdened PBGC.

This legislation will also enable steel companies to continue to seek long term solutions to their business problems by removing an imposing cloud of uncertainty. In brief, it would encourage much needed longer-term planning and solutions to the industry's problems and diminish the relative attractiveness of the Chapter 11 remedy. In addition, retirees' hard earned benefits will also be better protected under this program in contrast to today's environment where bankruptcies, plan terminations and PBGC benefit reductions prevail. Finally, it appears to us that the risks and cost to the government, in the form of guarantees and potential liabilities, are clearly no greater than they are under existing bankruptcy law and could be far less to the extent such legislation reduces the number of bankruptcies and facilitates the rejuvination of the industry.

Salomon Brothers Inc

While we believe that a Steel Retirements Benefits Authority ("Authority") is an appropriate vehicle for addressing the problem, care must be taken to ensure that it is properly administered. Of particular concern is the method by which the Authority would ensure that the value of the assets transferred is sufficient to cover the obligations assumed. Given the subjective nature of valuing stock warrants, so called "junk" or high yield bonds, and other financial instruments of below investment grade companies, this endeavor may become a very difficult and contentious issue. Public officials, participating steel companies and non participating steel companies each may have different perspectives on valuation issues. In order to address this concern, we suggest that serious consideration be given to providing for an independent valuation mechanism.

We also suggest that participating companies be subject to periodic review by the Authority. More specifically, we recommend that each participant be required to file a long term business plan outlining its strategy with the Authority and meet periodically with public officials to discuss financial and operating results. This is an appropriate quid pro quo for the assistance received from the government and would allow the public officials to monitor the participant's progress and evaluate the value of its collateral.

In conclusion, the Steel Retirement Benefits Funding Act of 1987 provides a positive approach to formally recognizing and resolving a critical problem facing our pension guarantee system and steel industry. This proposed legislation should be seriously considered by you and your subcommittee members.

Very truly yours,

E. Stephen Benson

E. Stephen Benson
Managing Director

Senator HEINZ. Gentlemen, I thank you very much. The hearing is adjourned.

[Whereupon, at 12:40 p.m., the subcommittee was adjourned.]

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